Monetization Manual
A Guide for Title II Cooperating Sponsors

First Printing: October 1999

Food Aid Management (FAM) is an association of 16 United States Private Voluntary Organizations and Cooperatives, working together to make food aid more efficient and effective. With its members, FAM works towards improved food security outcomes by promoting information exchange and coordination, providing forums for discussion and collaboration, and developing food aid standards.

This publication was made possible through the support provided by the Office of Food for Peace, Bureau for Humanitarian Response, United States Agency for International Development under the terms of Grant No. FAO-A-00-98-00081-00. The opinions expressed herein are those of FAM and its membership and do not necessarily reflect the views of the U.S. Agency for International Development.

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COOPERATING SPONSOR MONETIZATION MANUAL

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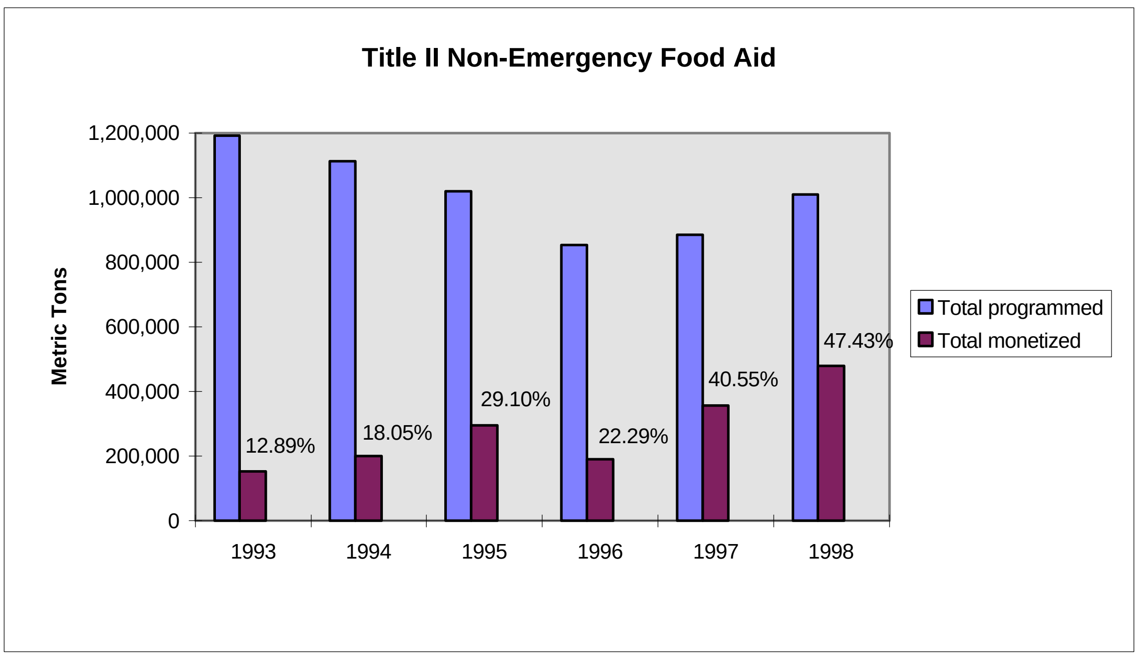
Foreword

During the late 1980s and early 1990s, an array of manuals, case studies, reports, and evaluations addressing monetization of PL 480 commodities were produced. A number of Title II Cooperating Sponsors (CSs), as well as Food Aid Management (FAM), drafted handbooks and manuals to guide their headquarters and field staffs through the intricate process of selling commodities in overseas markets. Academics published papers about the effects of monetized commodities on recipient countries' economies, and researchers undertook detailed studies to evaluate the development impact of monetization-supported projects. Within the last five years, however, very little new information has been circulated about this important topic, despite the dramatic increase in the percentage of commodities being monetized. Food for Peace reports that 47.43 percent of Title II non-emergency commodities was monetized in fiscal year 1998 as compared to 12.89 percent in fiscal year 1993 (see graph below for trend analysis). Moreover, the stringent nature of cost recovery requirements to which CSs must now adhere, worldwide trade liberalization, the privatization of the agricultural production and processing sectors in developing countries, and the business savvy and access to market information attained by many recipient-country traders have greatly increased the complexity of the monetization process. Finally, revisions of and updates to USG food aid legislation, regulations, policies, and guidance also compound the need for an updated monetization manual.



In response to these developments, a Monetization Working Group was formed at FAM's annual meeting in October 1997. One of the decisions taken by the Working Group was to commission the publication of an updated monetization manual for use by all Cooperating Sponsors engaged in the monetization of P.L. 480 Title II commodities. The manual, as conceived by the Working Group, would serve not only as a reference source on all aspects of monetization, but also as the foundation from which monetization training materials would be developed for use in both headquarters and field office workshops.

The manual that follows, and the accompanying training modules, respond to the need for up-to-date guidance on monetization. A great deal of the information that is included was drawn from existing monetization manuals, workshop materials, and other relevant literature. However, much of the information presented is new or has been revised in light of the valuable experience that CSs have acquired with respect to monetization. (Several chapters include case studies that highlight the "lesson learned" or "best practice" that emanated from the real-life experience.)

Acknowledgments

The production of this manual was made possible by Food Aid Management and the Monetization Working Group with funding from USAID's Office of Food for Peace. Numerous individuals were interviewed, provided case studies and sample documents, and replied to requests for clarification and additional information. The author, Bridget Ralyea, gratefully acknowledges their contributions.

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October 1999

Glossary

AER	Annual Estimate of Requirements. A document submitted with a CS's DAP, DAP Amendment, or PAA and approved by FFP and the USAID Mission that details the amount and type of commodity the CS will program during a given fiscal year.
BHR	Bureau for Humanitarian Response. Food for Peace is one office within this bureau.
Bellmon Amendment	This term refers to Section 403(a) of PL 480 which states: "No agricultural commodity shall be made available under this Act unless it is determined that (a) adequate storage facilities will be available in the recipient country at the time of the arrival of the commodity to prevent the spoilage or waste of the commodity; and (2) the distribution of the commodity in the recipient country will not result in a substantial disincentive to or interference with domestic production or marketing in that country."
Bellmon Analysis	Comprised of two components: a disincentive analysis and a commodity storage analysis. The Bellmon analysis serves as the basis for making a Bellmon Determination. A Bellmon analysis must be carried out prior to the initiation of any P.L. 480 (Title I, Title II, or Title III) program and, for multi-year programs, must be updated annually.
Bellmon Determination	A judgment made by a CS, based on information acquired through the Bellmon analysis, that Title II commodities may or may not be imported into a country. The Bellmon Determination is positive if: (1) adequate storage facilities will be available in the recipient country at the time of the arrival of the commodity to prevent the spoilage or waste of the commodity; and (2) the distribution of the commodity in the recipient country will not result in a substantial disincentive to or interference with domestic production or marketing in that country. The Bellmon Determination is negative if either or both of the above two statements is false. The Bellmon Determination must be certified by FFP. Where applicable, FFP certifies the Bellmon Determination based upon the recommendation of the cognizant Mission.
Bulk Commodities	Commodities that are not processed, fortified, or bagged. Whole wheat, corn, and beans are commodities that can be provided in bulk form.
CCC	Commodity Credit Corporation

C&F	Cost and Freight. A pricing term indicating that the cost of the goods and freight charges are included in the quoted price. The supplier must pay the costs and freight necessary to bring the goods to the named destination, but the risk of loss or damage to the goods, as well as of any cost increases, is transferred from the seller to the buyer when the goods pass the ship's rail in the port of shipment. The U.S. Government self-insures.
Cooperating Sponsor (CS)	For purposes of this manual, a private voluntary organization or cooperative that receives, or is seeking to receive, funding from USAID's Office of Food for Peace in order to implement a Title II-funded food security program
DAP	Development Activity Proposal. The document prepared by a CS and submitted to FFP requesting funding for the implementation of a Title II program in a particular country or region. A DAP may seek approval to implement the proposed program for up to five years. The term "DAP" is one of two new designations for "Operational Plan" as defined in Regulation 11.
DAP Amendment	A report submitted by the CS to USAID, in lieu of a PAA, in which the CS outlines and seeks approval of a significant change to its approved DAP
DAP/PAA Guidelines	A document, updated periodically by BHR/FFP that provides guidance to CSs on the preparation of DAPs, DAP Amendments, and PAAs
Emergency Guidelines	FFP's guidance for proposal preparation for emergency- and transition-focused Title II food assistance programs, more formally known as "PVO Guidelines for Title II Emergency Food Proposals and Reporting"
FACG	Food Aid Consultative Group. The group that, by law, meets regularly and makes recommendations regarding Title II regulations, guidance, and procedures. Included in the group are the USAID Administrator, the Inspector General, the USDA Under Secretary for International Affairs, and representatives of each PVO participating in the Title II program or receiving planning assistance funds, plus representatives from indigenous NGOs in recipient countries and the food industry.
FAM	Food Aid Management. An umbrella organization focusing on issues related to food aid and food security, whose members are Title II cooperating sponsors
FAS	Free Alongside Ship. A price quote that includes the cost of commodities and expenses associated with delivering the commodities to the dock at the U.S. port

FFP	Office of Food for Peace. The office within USAID's Bureau for Humanitarian Response that provides commodity and cash funding to CSs, the World Food Programme, and host governments, under the authority of Public Law 480, to address food insecurity in developing countries
FFP/D	Director of the Office of Food for Peace
Foreign Currency	The currency that is paid to the seller of commodities in a Title II monetization transaction
Hard Currency	A currency widely used as a means of exchange in international transactions
Indicators	Measurements used to determine the degree of progress that has been made toward achieving an objective
ITSH	Internal transport, storage, and handling. ITSH funds are awarded by FFP to support the costs of internal transport, storage, and handling incurred in Title II emergency programs.
Joint Monetization	See "Umbrella Monetization"
LIFDC	Low Income, Food Deficit Country. For purposes of Title II programming, LIFDCs are those food-deficit (i.e., net importing basic foodstuffs) countries with per capita GNP not exceeding the level used by the World Bank to determine eligibility for International Development Association (IDA) (soft loan) assistance. FFP references the list published by the Food and Agriculture Organization to determine a country's status as an LIFDC.
Lot	The minimum quantity, measured in weight, volume, or units, in which a commodity is offered for sale. A lot may be as large as an entire consignment or as small as the basic unit of commodity packaging.[1]
MFM	*Monetization Field Manual: P.L. 480 Title II Programs,* issued by FFP and dated October 16, 1998, which provides guidance on the monetization of Title II commodities
MT	Metric ton

[1] *Save the Children Monetization Implementation Manual: A How-to Manual on Implementing Projects in the Field*, Marine Overseas Services, Inc., February 1993, Section 5-3.

Monetization	For purposes of this manual, the sale of Title II agricultural commodities by a Cooperating Sponsor (CS) to one or more buyers in a foreign market
Monetization Proceeds or Monetized Proceeds	Funds generated through the sale of Title II agricultural commodities in approved monetization programs. Regulation 11 refers to "monetized proceeds" while the MFM refers to "monetization proceeds."
Monetization Request	That portion of a Title II development, emergency, or transition proposal in which a CS seeks USAID's donation of agricultural commodities for purposes of selling the commodities in an overseas market to generate foreign currency proceeds to be used to pay administrative and/or programmatic costs associated with a Title II program
Non-emergency Programs	Title II programs that are either development or transition in nature
Non-presence Country	A country in which no USAID Mission is operating
Operational Plan	A plan submitted by the CS describing the proposed use of commodities and/or monetized proceeds and/or program income. Once approved by FFP, the Operational Plan is attached to and made part of the Transfer Authorization. In FFP's *Monetization Field Manual* as well as in this manual, the Operational Plan is referred to as the "proposal" or in the case of a Title II development program, as a "DAP," "DAP Amendment," or "PAA."
PAA	Previously Approved Activity. The report submitted annually by a CS requesting a fiscal year allocation of commodities and dollars for a multi-year Title II activity. The term "PAA" is one of two new designations for "Operational Plan" as defined in Regulation 11.
POD	Program Operations Division. The division within Food for Peace that, with respect to monetization requests, determines the reasonableness of resources being requested, the allowability and allocability of budgeted expenses, and the appropriateness of proposed funding sources, e.g., 202(e) vs. monetization vs. ITSH. POD oversees FFP's budget and processes all calls forward.
PVO	Private Voluntary Organization

Pipeline	Commodities or monetization proceeds that were unused during the financial or reporting period and are transferred to the budget or planning levels for the following financial or reporting year
Presence Country	A country in which a USAID Mission is operating
REDSO	Regional Economic Development Support Office. An overseas office of USAID that focuses on a particular region. For non-presence countries, some Title II responsibilities may be delegated to REDSO.
Regulation 11	This regulation, more formally known as 22 CFR Part 211, responds to Section 207(c) of P.L. 480, which requires that regulations be developed to facilitate the implementation of the Title II program.
TA	Transfer Authorization. The document signed by the cooperating sponsor and USAID that describes the commodities being requested and the program in which they will be used. The TA incorporates USAID Regulation 11 and the CS's Operational Plan and authorizes CCC to ship the commodities.
Third-country Monetization	A monetization in which commodities are sold in one country and the foreign currency generated is used to support the implementation of a Title II program in that country and/or another country in the same region
UMR	Usual Marketing Requirements
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
USG	United States Government
Umbrella Monetization	Collaboration by two or more CSs who are implementing Title II programs in the same country or region to monetize their donated commodities jointly
W	Washington, DC, e.g., FFP/W means the Office of Food for Peace in Washington, DC
WFP	World Food Programme

Appendices

Chapter One

INTRODUCTION

After reading this chapter and/or receiving training in the chapter material, one should be able to:

- *describe briefly the various USG-sponsored food aid programs*
- *explain the purpose of Regulation 11*
- *list eight major topics on which Regulation 11 provides guidance*
- *summarize USAID's priorities for Title II food aid*
- *explain the purposes of the Food for Peace* Monetization Field Manual

1-1 Overview of Monetization

1-1.1 Definition

For purposes of this manual, monetization means the sale of Title II agricultural commodities by a Cooperating Sponsor (CS) to one or more buyers in a foreign market.

1-1.2 Purposes of Monetization

Monetization is used by Title II CSs to generate proceeds for use in their food security programs and as a development tool. In the latter case, CSs market commodities in lots that are small enough to encourage participation by small traders. Participation by the smaller traders opens up markets and makes them more competitive. It also facilitates the movement of commodities to communities where they are most needed. (The case study at the end of Chapter 8 illustrates how monetization was used to develop local markets in Uganda.)

> **Monetization** is used by Title II Cooperating Sponsors (CSs) to generate proceeds for food security and development programs. It has been used to compensate, to some extent, for the decline in foreign assistance resources. Foreign currency proceeds generated through monetization are used to cover both administrative and programmatic costs.

Monetization is a necessary mechanism for generating the cash needed to cover the administrative and programmatic costs associated with food security programs. The growth of monetization has been attributed by many to the decline in foreign assistance resources. The amount of USG cash resources available to private voluntary organizations and cooperatives to cover costs associated with distributing food aid commodities and to implement development programs overseas has spiraled downward in recent years. Those PVOs and cooperatives who work in the field of food security have been able to compensate, to some extent, for the shortage of dollar funding by monetizing Title II agricultural commodity resources. The foreign currency proceeds generated through monetization are used to cover a wide range of costs, both administrative and programmatic.

1-1.3 Uses of Proceeds

Regulation 11 states that the foreign currency generated by a monetization may: "(1) be used to transport, store, distribute, and otherwise enhance the effectiveness of the use of agricultural commodities . . . (2) be used to implement income generating, community development, health, nutrition, cooperative development, agricultural, and other developmental activities within the recipient country or within a country in the same region; or (3) be invested and any interest earned on such investment may be used for the purposes for which the assistance was provided to that organization . . ."[2] In recent years, USAID has encouraged CSs implementing development programs that have a monetization component to include all administrative and programmatic expenses that can be paid with foreign currency in their monetization budgets. The impetus for this directive is a shortage of U.S. dollar resources available to support Title II programs.

Note that the topic of allowable uses of monetization proceeds is discussed in greater detail in Section 4-2.1 of this manual.

1-2 Agricultural Trade Development and Assistance Act of 1954, as Amended (Public Law 480)

1-2.1 History of P.L. 480

U.S. farmers were among those who were hit particularly hard during the Great Depression of the 1930s. In order to save the farmers from economic ruin, the U.S. Congress was compelled to pass legislation aimed at improving farm prices, establishing price supports, and restricting production. The Commodity Credit Corporation (CCC), a government-owned corporation within the Department of Agriculture, was created in 1933 to stabilize and support farm prices. Despite these measures, except for brief periods during World War II, prices of agricultural commodities continued to plummet and surpluses, which were absorbed by the government, continued to accumulate.

Over-production prevailed in the United States throughout most of the 1940s, and by the early 1950s, European farm production, which had remained dormant during and in the early aftermath of World War II, was being revived. Europe's recovery led to a much-reduced reliance on imported food, which exacerbated the plight of U.S. farmers.

In 1949, Congress passed the Agricultural Act of 1949, which enabled voluntary agencies to receive CCC surplus commodities that would otherwise be spoiled. Despite the ever-growing stocks of farm products, however, the supply of surplus commodities to voluntary agencies was inconsistent and unpredictable. In July of 1953, the Senate Committee on Agriculture and Forestry conducted hearings to consider a bill giving the President authority to use farm surpluses for famine assistance overseas. This bill evolved

[2] P.L. 480, Section 203(d).

into Public Law 480 and was signed into law on July 10, 1954. The law provides as follows:

> It is the policy of the United States to use its abundant agricultural productivity to promote the foreign policy of the United States by enhancing the food security of the developing world through the use of agricultural commodities and local currencies accruing under this Act to–
>
> (1) combat world hunger and malnutrition and their causes;
>
> (2) promote broad-based, equitable, and sustainable development, including agricultural development;
>
> (3) expand international trade;
>
> (4) develop and expand export markets for United States agricultural commodities; and
>
> (5) foster and encourage the development of private enterprise and democratic participation in developing countries.[3]

As described below, P.L. 480 provides a number of mechanisms for enhancing the food security of the developing world.

1-2.2 P.L. 480–Titles I, II, and III

Although this manual deals primarily with Title II commodities, it is useful for the CS to be familiar with Titles I and III as well as with other government-sponsored food programs as these programs can have an impact on new and ongoing Title II programs.

1-2.2.1 Title I–Trade and Development Assistance

The U.S. Department of Agriculture (USDA) oversees Title I. Title I transactions involve concessional sales of agricultural commodities by the U.S. Government to developing countries and private entities. Sales are concessional in nature in that they offer the buyer extended payment periods and low-interest financing.

1-2.2.2 Title II–Emergency and Private Assistance Programs

The U.S. Agency for International Development (USAID) is the agency tasked with administering Title II food aid programs. Under Title II, the U.S. Government furnishes agricultural commodities to meet both emergency and non-emergency food needs.

1-2.2.3 Title III–Food for Development

USAID also administers the P.L. 480 Title III program. Under Title III, the U.S. Government donates agricultural commodities to least developed countries through a government-to-government bilateral program. The commodities are sold in the recipient

[3] *Ibid.*, Section 2(1-5).

country, and the monies generated by the sale are used to support economic development activities.

1-3 Other USG-Sponsored Food Assistance Programs

1-3.1 Food for Progress

This program authorizes the CCC to finance the sale and export of agricultural commodities on credit terms, or on a grant basis, to support developing countries and countries that are emerging democracies and have made commitments to introduce or expand free enterprise elements within their agricultural economies. Commodities may be provided under the authority of P.L. 480-Title I or Section 416(b).

1-3.2 416(b) Food Assistance

This program provides for overseas donations of surplus commodities owned by the CCC to carry out assistance programs in developing countries. Surplus commodities acquired by the CCC as a result of price support operations may be made available under section 416(b) of the Agricultural Act of 1949 if these surplus commodities cannot be sold or otherwise disposed of without disrupting price support programs or at competitive world prices. These donations are not permitted to reduce the amount of commodities that traditionally are donated to domestic feeding programs or agencies, prevent the fulfillment of any agreement entered into under a payment-in-kind program, or disrupt normal commercial sales.

1-4 Regulation 11

1-4.1 Purpose of Regulation 11

Section 207(c)(2) under Title II of P.L. 480 requires that regulations be developed with the intent of: "(A) simplifying procedures for participation in the programs established under this title; (B) reducing paperwork requirements under such programs; (C) establishing reasonable and realistic accountability standards to be applied to eligible organizations participating in the programs established under this title, . . . (D) providing flexibility for carrying out programs under this title."[4]

> **Regulation 11** spells out the responsibilities associated with operating a Title II program. Amendments in 1992 broadened the scope of allowed uses of monetization proceeds.

The regulation in 22 CFR Part 211, better known as Regulation 11, fulfills this requirement of P.L. 480. It provides guidance on: 1) the various agreements that CSs must have in place in order to implement a Title II program; 2) the availability and shipment of commodities; 3) the obligations of CSs; 4) processing, repackaging, and labeling of commodities; 5)

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[4] *Ibid.*, Section 207(c)(2).

arrangements for commodity entry and handling in the foreign country; 6) disposition of commodities unfit for authorized use; 7) liability for damage or improper distribution of commodities; 8) records and reporting requirements; and 9) suspension, termination, and expiration of programs. Regulation 11 is attached to this manual as Appendix A.

Special Note: It is crucial for a CS to have someone on staff, both at headquarters and in each field office where a Title II program is being implemented, who is intimately familiar with Regulation 11. The regulation spells out not only the responsibilities associated with operating a Title II program, but also the rights of the CS.

1-4.2 Amendment of Regulation 11

Regulation 11 was amended effective May 7, 1992, in order to coincide with the 1990 amendment of P.L. 480. The final revised regulation, including comments made by interested parties on progressive drafts and responses to those comments, as well as principal changes to the earlier version of the regulation, appeared in the Federal Register on that date.

1-4.3 Principal Changes Incorporated in the Amended Regulation

The principal changes incorporated in the amended regulation appear in Section C of the document. Changes related to monetization and/or the use of monetization proceeds are summarized here. Section 211.4(b) explains the transfer to and retention of title to commodities, monetization proceeds, and program income by the CS. Section 211.5(k)(1)(iii) authorizes the use of monetization proceeds and program income to fund endowments. Sections 211.5(k)(1)(iv) and (v) authorize the use of monetization proceeds and program income to finance improvement of a CS's management systems as well as for headquarters indirect costs, and those costs of in-country and regional offices that are allocable to Title II programs. Sections 211.5(k)(4) and (5) prohibit the use of monetization proceeds and program income to perform abortions or to finance the production for export of agricultural commodities that would compete with those of the United States in the world market. Section 211.6(a) provides more flexibility in the use of monetization proceeds and program income for financing the costs of processing, repackaging, or reprocessing commodities in the country of distribution. Finally, Section 211.9(d) requires that USAID take into consideration the problems associated with carrying out programs in the developing country where an activity is being implemented as well as normal commercial practices there when determining the liability of the CS for loss, damage, or misuse of commodities or monetization proceeds.

1-5 USAID's *Food Aid and Food Security Policy* Paper Dated February 1995

1-5.1 Purpose

USAID's *Food Aid and Food Security Policy* paper[5] sets forth the agency's policy for programming Title II and Title III resources effectively and efficiently to promote sustained improvements in food security in needy countries. USAID's priorities for Title II development programs are improvement of household nutrition and increases in agricultural productivity in those countries where food is needed most and food insecurity is greatest, especially in sub-Saharan Africa and South Asia. The policy paper affords CSs considerable flexibility in designing and programming interventions to meet these objectives.

1-5.2 Overview

The paper introduces the concept of "managing for results" and requires that performance monitoring and assessment systems be established so that the impact of food-assisted activities on food security can be measured objectively. The paper also calls for using food aid resources in conjunction with complementary programs to enhance impact and to build local capacity in order to ensure that communities will continue to move forward even after they have "graduated" from the Title II program.

The policy paper does not specifically address monetization-funded programs but does state that "proceeds from the monetization of food can be used to complement direct feeding programs and to support development programs, particularly those which enhance agricultural productivity and/or improve household nutrition."[6]

1-6 *Monetization Field Manual*

1-6.1 Purpose

The Food for Peace *Monetization Field Manual* was originally published in 1988. A revised *Monetization Field Manual*[7] (hereafter referred to as MFM) was prepared by FFP in cooperation with the CS community and was issued on October 16, 1998. The revised manual sets forth FFP's policy with regard to Title II monetization and outlines the operational procedures to follow when designing, implementing, and reporting on Title II monetizations.

Note: As with Regulation 11, CS headquarters and field staff should be intimately familiar with the MFM.

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[5] This policy paper is available on USAID's website at www.info.usaid.gov/hum_response/ffp/fspolicy.htm

[6] *Food Aid and Food Security Policy* paper, USAID, February 1995.

[7] FFP's *Monetization Field Manual* is available on USAID's website at www.info.usaid.gov/hum_response/ffp/monetiz.htm

1-6.2 Overview

The MFM is divided into two sections. The first section outlines the policy framework for Title II monetization. This section provides background information on monetization and discusses the requirement that monetization proceeds be used to address a number of food security objectives. The importance of avoiding disincentive effects of monetized food aid by conducting thorough market analyses and selling through open and competitive channels is emphasized. The policy framework section also covers cost recovery requirements, spells out review and evaluation criteria for FFP approval of a monetization request, and discusses monetizing in emergency situations.

The second section of the MFM presents the Implementation Guidelines for preparing and conducting a monetization transaction. This section explains the costs that must be recovered when commodities are sold as well as preparation of a monetization request, including the monetization sales budget and plan for managing the proceeds. The Guidelines list the roles and responsibilities of the Mission during proposal development, and describe the process for reviewing and approving a monetization request.. This section also explains procedures for obtaining price quotes and calling forward commodities, as well as the requirements for conducting the actual sale. Finally, section two provides guidance for conducting third-country monetizations.

> Over 45 percent of non-emergency Title II commodities was monetized in FY98. The Food for Peace **Monetization Field Manual**, revised in 1998, sets forth FFP policy and implementation guidelines for preparing and conducting Title II monetization activities.

1-7 The Current State of Monetization - September 1999

Over 45 percent of non-emergency Title II commodities was monetized in FY98. This exceeds the minimum amount of 15 percent that is legislated in P.L. 480 by more than 30 percent. A number of stakeholders in the Title II program have raised serious objections to such a high rate of monetization because of its potential impact on their particular interests.

Who are these stakeholders? In addition to the CSs, they include: American farmers, American trucking, rail, and steamship companies, American longshoremen, American food processors, packaging manufacturers, and baggers, to name but a few. In addition to the minimum percentage of non-emergency commodities that must be monetized, P.L. 480 legislates other “minimums” and “subminimums” for Title II that serve the interests of the non-CS stakeholders. For example, 2,025,000 metric tons of commodities must be provided annually under Title II of which not less than 1,550,000 metric tons must be made available for non-emergency programs. A minimum of 75 percent of non-emergency Title II commodities must be processed, fortified, and/or bagged. (See Appendix B for a list of these types of commodities.) Fifty percent of bagged commodities that are whole grain commodities must be bagged in the United States. Finally, 75 percent of non-emergency commodities must be shipped via U.S.-flag carriers.

Why is the percentage of monetized commodities of concern to these stakeholders? The farmers and food processors, who are represented by various agricultural producer and processor groups, are concerned because CSs generally have been requesting only a few types of commodities for monetization. This is true solely because CSs are responding to market forces and other practical factors, such as recipient-country shortages, buyer preferences, and governmentally imposed limits on the importation of goods (recipient country governments sometimes restrict the importation of value-added commodities in order to support local processing and refining industries). Bulk hard wheat is one example of a preferred commodity for monetization, since it is not widely produced in Title II recipient countries and yet is often required for blending with soft wheat. The amount of bulk hard wheat being shipped has increased commensurate with the percentage of commodities being monetized. Consequently, the producers, processors, and baggers of commodities that were typically used in distribution programs (e.g., corn soy blend and bulgur wheat) are voicing concerns that their commodities are not being programmed and monetization is therefore having a negative impact on their industries. On the other hand, U.S. parties who have financial investments in processing mills and refineries located in Title II countries support the monetization of bulk commodities. Finally, commercial exporters and brokers are concerned that the monetization of commodities by CSs will negatively affect their sales opportunities. Clearly, there is a wide range of competing interests.

The Title II CSs, USAID, USDA, and agricultural producer and processor groups have been engaged in a dialogue to resolve the complex issues surrounding monetization. Among the remedies that have been discussed are: increased programming by the CSs of a wider variety of commodities, an increase in the amount of 202(e) cash resources available to support Title II programs, collaboration between CSs and Missions to develop strategies and activities that include Title II resources, and improved coordination of donors.

On May 24, 1999, FFP issued supplemental monetization guidelines[8] that were meant to reflect the discussions that had taken place among the Title II stakeholders. FFP has stated that the guidelines "will be used in a pilot program over approximately the next two years in conjunction with BHR/FFP's *Monetization Field Manual*, and the Development Activity Proposal (DAP) and Previously Approved Activity (PAA) Guidelines . . . in review of cooperating sponsor monetization activities proposed in Title II-assisted development interventions."

The CS community raised strong objections to both the content of the supplemental guidelines, which they deemed redundant, and the timing of their issuance. During the 30-day comment period following the announcement of the supplemental guidelines, the CSs

[8] Notice to the Federal Register, vol. 64, no. 99 (24 May 1999).

documented their objections in formal letters to USAID.[9] Despite their opposition, the guidelines were adopted by FFP. They are set forth below.

1. In general, Title II monetization activities will not be undertaken where they would disrupt commercial markets for U.S.-produced agricultural commodities.

2. Proposals advocating the monetization of value-added (i.e., processed, fortified, bagged, or refined) Title II commodities and sales designed and executed in consultation with the U.S. food export and processing trade will receive priority.

3. BHR/FFP will give priority to monetization in the recipient country.

4. Priority will also be given to monetizations supporting or complementing the direct distribution of value-added Title II commodities and/or resulting in benefits directly linked to the reduction of hunger.

5. Development interventions entirely based on the monetization of Title II commodities will also continue to be considered by BHR/FFP so long as their benefits can be directly linked to reduction of food insecurity and/or where the U.S. food itself has clear benefit to hungry people.

6. If there are compelling reasons that preclude in-country monetization, consideration will be given to monetization in an adjacent (i.e., a closely neighboring) country following consultations with U.S. commercial interests in all instances. Regional monetizations will be considered only on an exceptional basis and only after full consideration.

[9] CS field offices may obtain copies of the letters from their headquarters office or from Benchmarks, Inc., 3248 Prospect Street NW, Washington, DC, 20007, 202-965-3983.

Chapter Two

STARTING UP A TITLE II MONETIZATION-FUNDED PROGRAM – FIRST STEPS

After reading this chapter and/or receiving training in the chapter material, one should be able to:

- *discuss the need to establish contact with USAID*
- *explain the purpose of a needs assessment*
- *explain how a concept paper differs from a needs assessment and list at least four components of a concept paper*
- *list three reasons why coordinating with other CSs and donors is important*
- *list three things to consider in determining whether monetization would be appropriate for a particular country*

2-1 Eligibility Requirements

In order to become a Title II CS, a U.S.-based organization must be registered with USAID's Office of Private and Voluntary Cooperation (PVC). The organization must complete USAID Form 1550-2 and provide additional information and documentation as required by PVC. A copy of this form is attached as Appendix C. Application packets may be obtained from Food Aid Management, 300 I Street, N.E., Suite 212, Washington, DC, 20002, 202-544-6972.

2-2 Making Contact with USAID

CSs should contact USAID concerning their intention to initiate a Title II partial or 100 percent monetization program. The CS will need to substantiate adequately to USAID the need for a monetization program. In some cases, the CS may learn that a number of other monetization programs are already operating in-country and that the local marketplace would not be able to support additional food aid commodities. In such situations, USAID may withhold its recommendation to move forward with developing a proposal. Therefore, it is advisable to defer the expending of scarce resources to develop a concept paper or proposal for a monetization-funded program until there is joint CS and USAID agreement to do so.

2-2.1 Contacting the USAID Mission

USAID Mission attitudes toward Title II programs in general and monetization in particular range from strong support to adamant opposition. In some countries, as many as a half dozen partial or 100 percent monetization programs are operating, and the Food for Peace Officers are amenable to entry by additional CSs who propose and have the expertise to implement strategic complementary and/or supplementary activities. On the other hand, some Missions, even some of those located in food deficit countries, resist the prompting of CSs and FFP to start up Title II programs. This resistance may stem from one or more of the following circumstances: 1) no one on staff is familiar with Title II; 2) the Mission is understaffed and feels it would not be able to provide adequate oversight; 3) the Mission has previously had negative experiences with food aid. In the past, Missions may have rejected a CS's proposal because it did not fit in with USAID's development plan for the country. Section 202(b)(2)(B) of P.L. 480 now specifically prohibits USAID from refusing to consider a Title II program for this reason.

In presenting to a USAID Mission its arguments for a monetization program, a CS should be able to:

1) discuss specifically the conditions of food insecurity in the country, including: percentage of the population that is food insecure, particularly among women and children; causes of food insecurity; and specific regions or pockets of food insecurity in the country. This information may be obtained from such sources as WFP, FEWS[10], the World Bank, and national government data.[11]

2) explain how the CS has successfully addressed food insecurity in one or more other countries and convince the Mission of its expertise in programming monetization proceeds

3) marshal examples of how the CS was able to resolve monetization-related problems without relying on intervention by the cognizant Mission

4) if relevant, explain how the Title II program might tie into one or more of the Mission's strategic objectives and complement existing Mission-funded activities

5) for partial monetization requests, explain the need for cash resources to support the distribution of commodities

A CS may seek FFP's support in presenting its case for monetization to a Mission. FFP has the worldwide perspective of seeing successful activities, including monetization, being implemented by CSs using Title II resources. It can cite examples of how and why the proposed activity is important and will be effective. Since FFP is required by law to make available 2,025,000 metric tons of commodities, and in past years has had difficulty

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[10] USAID's Famine Early Warning System (FEWS) is an information system designed to help prevent famine in sub-Saharan Africa. Additional information about this system is available from the FEWS website at www.fews.org.

[11] Following are some useful websites:
www.wfp.org/OP/index.html for country-specific information
www.fao.org
www.fao.org/giews/
www.fao.org/giews/english/query-e.htm for country-specific information
for Africa, www.fews.org/ and links shown on this site
www.worldbank.org/html/extdr/regions.htm for country-specific information

meeting this requirement, it is in FFP's interests to have as many Missions as possible support Title II programming.

2-2.2 Non-presence Countries

FFP's DAP/PAA Guidelines present FFP's policy concerning Title II non-emergency activities in non-presence countries. The guidance reads as follows:

> Current P.L. 480 Legislation provides that Title II-assisted non-emergency activities may not be denied solely because they are to be carried out in a country in which there is no USAID presence. Therefore, BHR/FFP will consider DAPs for non-presence countries individually based upon the same criteria as presence countries. BHR/FFP will look to the concerned U.S. diplomatic post to review and comment on the proposal, providing concurrence or nonconcurrence, per the instructions for Mission comments. Where possible, REDSOs [Regional Economic Development Support Offices], or bilateral Missions with oversight responsibilities for the non-presence country will also review and comment on the proposal. BHR/FFP will conduct reviews of non-presence country DAPs either in Washington or in the field at a Mission having oversight responsibilities for activities in the non-presence country. Regional Bureau representatives and Regional Food for Peace Officers will be included in the review process.
>
> Following a DAP's review by BHR/FFP and the appropriate Mission, and the approval of Title II resource commitments to it by the Director, BHR/FFP, an action memorandum recommending the DAP as a non-presence country activity will be addressed by the Director, BHR/FFP, to the relevant Assistant Administrator and cleared by USAID's Bureau for Management. Approval of DAPs for non-presence countries is individually based on the following merits (which are consistent with DAP review criteria): 1) potential development impact; 2) a plan for sustainability of post-activity benefits; 3) complementarity with other donor and host-government activities; and 4) a management and program monitoring and evaluation plan.[12]

2-2.3 Contacting Food for Peace

The Office of Food for Peace (FFP) comprises three divisions: the Emergency Response Division (ER); the Development Programs Division (DP); and the Program Operations Division (POD). Food for Peace Officers in ER and DP oversee Title II programs in their countries of assignment. A CS that is considering initiating a Title II program in a particular country should contact the appropriate FFP Officer to discuss its plans *at the same time that it contacts the cognizant USAID Mission*. Experience has shown that

[12] DAP/PAA Guidelines for FY 2000, Chapter 1, Section II.F.

maintaining a three-way dialogue–among the CS, the Mission, and FFP–will help expedite USAID's recommendation. In countries where no Title II programs are operating, and hence no FFP Officer has been assigned, the CS is advised to contact the appropriate Division Chief, depending on whether the proposed activity is emergency or development in nature. In all cases the FFP Officer or Division Chief will confer with the USAID country desk officer in the relevant Regional Bureau concerning a proposed Title II program. The CS should ensure that it is kept apprised of discussions between FFP and the desk officer.

2-3 Needs Assessments

2-3.1 Background

A CS conducts a needs assessment (formerly referred to by FFP as a "feasibility study") to identify a food security problem in a low income, food deficit country (LIFDC) and to determine whether Title II resources can effectively and efficiently be employed to address the causes and effects of food insecurity in that country. The timing of the assessment depends on both the CS and the source of funding for the assessment. FFP requests that CSs who are using Institutional Support Assistance (ISA) funds obtain a recommendation from FFP *before* moving ahead with the assessment. FFP will want the Mission's input before making a recommendation, so, as discussed above, the CS is advised to contact the Mission and FFP simultaneously. If a CS is paying for the study with private funds, the CS can elect to conduct the study prior to establishing contact with USAID. Needs assessments are not submitted to USAID, but much of the information they contain is ultimately presented to USAID in the form of a concept paper or proposal.

2-3.2 Content

No formal written guidelines exist on how to conduct a needs assessment, so a CS can tailor a study to meet its need for information, its budget, and its time frame. If the CS is already working in-country on a non-Title II-funded project, it may well have much of the information needed to draft a proposal. It may already know, for example, the nature and extent of a country's food insecurity; which, if any, PVOs, NGOs, and host country government ministries are working to alleviate the causes and effects of food insecurity; which populations are underserved and/or at greatest risk; etc. A lengthy and costly needs assessment is probably not warranted under such circumstances.

A CS that is not currently working or has not previously worked in a country where it is considering starting up a Title II program would need to undertake a more comprehensive study. One of the first things a CS should find out is how familiar the host country government is with monetization as well as how amenable it would be to allowing commodities for monetization into the country tax- and duty-free. The CS should also look at production and consumption levels, commodity imports, sales systems, financial institutions, population growth rate, rural to urban migration levels, eating habits of the poor, trends in changes in eating habits (and thus changes in demand for certain commodities), political sensitivities toward certain commodities (e.g., does the government have a plan to be self-reliant in crop X by year Y?), potential conflict with U.S.-based commodity groups, Ministry of Agriculture investment in targeted crops, other bilateral and multi-lateral programs, etc. The CS also needs a clear understanding of the marketing system to evaluate the potential commercial sales of a given commodity or commodities. A solid, well researched needs assessment serves as the foundation for a Title II program proposal.

2-3.3 Funding

As mentioned above, a CS that has an ISA cooperative agreement with FFP can use funding provided under the agreement to cover the cost of a needs assessment, as long as the study has been included in a budget submitted to and approved by FFP.[13] FFP asks to be notified before the CS initiates any studies funded with ISA resources. A CS's private funds can, of course, be used to pay for needs assessments. A CS cannot be reimbursed with monetization proceeds or Section 202(e) funds for the costs it incurs in preparing a needs assessment.

2-4 Concept Papers

When a CS is considering starting up a development program in: 1) a country that is in transition between emergency and development, 2) a non-presence country, or 3) an area where Title II is not currently being programmed, USAID may request that the CS submit a concept paper prior to preparing a full-scale proposal. Note that concept papers are not required for emergency programs.

2-4.1 Purpose

A concept paper will provide USAID with the following: 1) a problem statement that addresses the nature, scope, consequences, and causes of a country's or region's food insecurity; 2) the purpose of the project being proposed; 3) the project goals and objectives; 4) the expected results/impact; 5) information concerning collaboration and integration with other projects in the area; 6) and the critical resource needs and anticipated sources.

2-4.2 Guidance

The CS can find help in preparing concept papers in the annual DAP/PAA Guidelines.[14] The most recent edition of this guidance is known as "Bureau for Humanitarian Response,

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[13] Those CSs who do not receive ISA funding from FFP will have to absorb the cost of conducting a needs assessment as an administrative expense of the organization.

[14] CSs should be able to obtain the most recent DAP/PAA Guidelines from FFP's website at www.info.usaid.gov/hum_response. However, there may be a delay between the release of the guidance and the updating of the website.

Office of Food for Peace, Development Programs Team P.L. 480 Title II Guidelines for Fiscal Year 2000 Program Proposals" and is dated December 9, 1998.

2-4.3 Funding

A CS may not use ISA funds to prepare a concept paper. Furthermore, a CS cannot be reimbursed with monetization proceeds or Section 202(e) funds for the costs it incurs in preparing a concept paper.

2-5 Bellmon Analysis

The procedures for conducting a Bellmon analysis are discussed in detail in Chapter 5. However, a brief discussion of this important component of Title II programming is included here.

2-5.1 Overview of Bellmon Determination

In the 1970s, Congress became concerned about the disincentive effects food aid was having on production and marketing in developing countries, and about the capacity of developing countries to store the large quantities of commodities that were being provided. As a result, the P.L. 480 legislation included the following provision:

> No agricultural commodity shall be made available under this Act unless it is determined that– (1) adequate storage facilities will be available in the recipient country at the time of the arrival of the commodity to prevent the spoilage or waste of the commodity; and (2) the distribution of the commodity in the recipient country will not result in a substantial disincentive to or interfere with domestic production or marketing in that country.[15]

Bellmon Analysis

The Bellmon Amendment has been part of P.L. 480 legislation since 1977. It prohibits making agricultural commodities available for P.L. 480 programs unless storage in the recipient country is adequate and distribution of the commodity will not interfere with the country's domestic production or marketing.

This provision is known as the Bellmon Amendment. It was named after Senator Henry Bellmon of Oklahoma who introduced the amendment to Congress; it has been part of P.L. 480 legislation since 1977.

A *positive* Bellmon Determination is made when it is found that 1) adequate storage facilities are available in-country and 2) importation of the commodity will not result in a substantial disincentive to or interfere with domestic production or marketing. Conversely, a *negative* Bellmon Determination is made when it is found that either

[15] P.L. 480, Section 403(a).

1) storage facilities available in-country are inadequate and/or 2) importation of P.L. 480 commodities will result in a substantial disincentive to or interfere with domestic production or marketing.

The Bellmon Determination is supported by a Bellmon analysis, which is prepared prior to the initiation of a P.L. 480 program. The Bellmon Determination is certified by the director of FFP (FFP/D) upon the recommendation of the principal officer of the USAID Mission or U.S. Diplomatic Post, depending on whether a CS's proposal and hence the Bellmon analysis has been reviewed in a USAID presence or non-presence country.[16]

Special Note: The Bellmon analysis is conducted for the country where P.L. 480 commodities will be distributed and/or monetized. In the case of a third-country monetization, a Bellmon analysis must be carried out for each country where commodities are to be monetized.

2-5.2 Bellmon Analysis Requirement

A Bellmon analysis must be carried out prior to the initiation of any P.L. 480 (Title I, Title II, or Title III) program. In countries where P.L. 480 commodities are already being programmed, the CS would review the existing Bellmon analysis to determine whether the marketplace can absorb the additional commodities the CS would need to import to support a Title II program and whether storage facilities are adequate. If the Bellmon analysis indicates that no more of a particular type of commodity (or commodities) can be brought in without resulting in a negative Bellmon Determination, then the CS might explore programming a commodity that is not covered in the existing Bellmon analysis. In this case, the CS would have to conduct a new Bellmon analysis.

In a country where no Title II or other P.L. 480 program is operating, the CS must conduct its own Bellmon analysis, unless an analysis is being carried out by USAID. (See Chapter 5 for more information about conducting a Bellmon analysis. CS field offices are encouraged to contact their respective headquarters to obtain sample Bellmons.) Bellmon analyses are submitted to USAID as supporting documentation for the positive (or negative) Bellmon Determination. USAID reviews the analyses and, if it deems them acceptable, uses them as the basis for certification of the Bellmon Determination.

Note that the Bellmon Determination must be recertified each year. For multi-year development programs, the Bellmon analysis must therefore be updated annually and included in the CS's PAA along with the CS's request for commodities.

2-5.3 Funding for Bellmon Analyses

The costs associated with an initial Bellmon analysis, which must be conducted prior to implementation of a Title II program, must be paid for with the CS's own funds. The cost

[16] For more detailed guidance on Bellmon certification, see FFP's cable re: "Bellmon Certification Requirements for P.L. 480 Title II Activities" in Appendix D.

of an annual update to the Bellmon analysis can, however, be covered with monetization proceeds as long as the CS budgets for it in the PAA and as long as the Bellmon update relates to the existing DAP and not a follow-on DAP.

2-6 Other Cooperating Sponsor and Donor Food Aid Programs

While investigating whether or not to initiate a Title II program, the CS must learn as much as possible about the various food assistance programs that exist or are likely to start up in the country under consideration, including other CS programs, WFP programs, non-Title II USG programs, and food assistance programs of other countries or regions, such as Canada, the European Union, etc. The CS should be aware not only of the existence of other programs, but also of their size, nature (monetization or direct distribution), length of operation, expected duration, and time during the year they intend to bring in food. Through coordination with other CSs and other donors, a CS can help ensure the success of its program by 1) designing complementary and/or supplementary activities that will enhance the effectiveness of all food assistance programs; 2) selecting appropriate, and not "over-programmed" commodities; and 3) timing the importation of commodities so as to avoid massive inflows of food that the marketplace, processors, refiners, host country counterparts, beneficiaries, etc., in the recipient country cannot accommodate.

To learn about other food assistance programs, the CS can contact the USAID Mission and the U.S. Embassy Agricultural Attaché. If no Mission is present, the CS can contact FFP directly to find out about other CS, Title III, and WFP programs and contact USDA for information about Title I, 416(b), and Food for Progress programs. For information about non-U.S. food aid programs, the CS should meet directly with the managers of these programs.

Finally, when two or more CSs are monetizing in a country, USAID strongly recommends that they coordinate their activities under an umbrella monetization. Umbrella monetizations are discussed in greater detail in Chapter 6.

2-7 Is Monetization the Right Choice?

Everyone reading this manual knows that the process of monetizing Title II commodities is extraordinarily complex. Commodity and foreign exchange markets are volatile, information flows are imperfect, governmental red tape is limitless, and dealing with buyers from different cultures can be extremely challenging. Despite these and many other obstacles, CSs time and again decide to implement monetization-funded programs.

Given the complex nature of monetization, there is no surefire way to ensure that a monetization program will be successful. However, if the following statements are true, a CS can be reasonably sure that a monetization program can be successfully implemented in a given country.

1) The Bellmon analysis has resulted in a positive Bellmon Determination for at least one commodity as well as an alternative commodity. It is strongly recommended that at least two commodities be deemed suitable for monetization because regulations and/or policies that prohibit or limit the importation of a particular commodity may be imposed with little or no warning. For example, USDA may determine that because of supply constraints, it cannot make the commodity available for Title II programming. Or a recipient-country government could elect to impose a high import tax or duty on the commodity to protect one or more sectors of the economy. If a CS is programming the commodity that has suddenly become unavailable or subject to a high tax, it may have to suspend activities or discontinue them altogether unless it can readily substitute another commodity. Note that if the Bellmon analysis results in only two qualifying commodities, the two should ideally be unrelated. For example, if the Bellmon analysis indicates that corn is the most appropriate commodity to import and monetize, then the CS should not rely on corn meal as the alternative commodity because if corn becomes unavailable, corn meal is also likely to become unavailable.[17]

2) The recipient-country government is amenable to the monetization of food aid commodities. *Ideally*, it has agreed to exempt the commodities from taxation or to reimburse the CS, either with cash or in-kind contributions, for duties and taxes paid by the CS.[18]

3) The CS has on staff, or is able to hire the services of, someone who has extensive knowledge of the marketplace in which the monetization will be conducted and prior experience in managing monetization transactions of the type that will be conducted in the given country (i.e., tender bid, auction, or negotiated sale).

[17] Note that monetization has been successfully used to support Title II programs in countries where the Bellmon analysis indicated that only one commodity could be monetized. The notion of at least two qualifying commodities is an ideal, but monetization should not necessarily be ruled out in countries where only one commodity has been deemed suitable.

[18] The payment of duties and/or taxes on Title II commodities for direct distribution is prohibited. No such prohibition exists for commodities targeted for monetization; however, Section VI.C. of the Implementation Guidelines section of FFP's MFM encourages CSs to "negotiate agreements with host governments which permit the tax-free import of commodities for monetization." The MFM states that if taxes are paid on monetization commodities, they must be included as a cost to be recovered in the cost recovery benchmark calculation. In some cases, but only up to a certain limit, FFP has permitted the host government to contribute in-kind donations to the CS's program to compensate the CS for the cost of taxes and/or duties paid.

Chapter Three

PROGRAM AGREEMENTS AND FFP GUIDELINES

After reading this chapter and/or receiving training in the chapter material, one should be able to:

- *list at least four provisions that should be included in a Host Country Food for Peace Agreement*
- *define the term "Recipient Agency" and describe the purpose of a Recipient Agency Agreement*
- *list two FFP documents that should be referenced when preparing a Title II development program proposal and two FFP documents that should be referenced when preparing a Title II emergency or transition program proposal;*
- *explain under what circumstances FFP may exempt a CS from achieving the Cost Recovery Benchmark*
- *calculate a Preliminary Cost Recovery Estimate*

3-1 Required Agreements

Section 211.2 of Regulation 11 defines two types of agreements that a CS must have in place to program Title II commodities, and a third type of agreement that is required under certain circumstances.

3-1.1 Food for Peace Program Agreement

A CS must execute a Food for Peace Program Agreement with FFP prior to starting up its first Title II program. According to Regulation 11, this agreement "establishes a nongovernmental organization as a cooperating sponsor for which USAID agrees to authorize future transfers of commodities in accordance with title II of Public Law 480 and Regulation 11 and the cooperating sponsor agrees to accept transfer of commodities in accordance with approved programs under title II and USAID Regulation 11 and related procedures."[19] A sample Food for Peace Program Agreement is included as Appendix E.

3-1.2 Host Country Food for Peace Agreement

A Host Country Food for Peace Agreement must be in place before a CS initiates a Title II program in a foreign country. Regulation 11 defines this document as "an agreement between the cooperating sponsor and the foreign government of each cooperating country which authorizes the cooperating sponsor to conduct activities there in a manner consistent with the terms and conditions set forth within this Regulation 11."[20] Section 211.3(c) of Regulation 11 discusses the need for and nature of this agreement.

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[19] 22 CFR Part 211, Section 211.2(j)(1).
[20] *Ibid.*, Section 211.2(j)(2).

The Host Country Food for Peace Agreement should be negotiated such that it:

- exempts the CS from local regulations governing business and acquiring trading licenses;
- authorizes the CS to conduct business and trade in agricultural commodities;
- authorizes the CS to pursue, through the local judicial system, any disputes that might arise from monetization;
- exempts the CS from payment of all import duties, taxes, and other levies on the importation and sale of Title II commodities [see footnote 17 of this manual for information about import duties and taxes];
- gives the CS control over the disbursement of sales proceeds;
- obliges the host government to enforce, on behalf of the CS, the non-export provision of the sales agreement;
- incorporates Regulation 11 as an annex, stipulating that it constitutes a part of the agreement;
- stipulates that a copy of the agreement be provided to the USAID Mission, if a Mission is present, otherwise to the Diplomatic Post.[21]

A sample Host Country Food for Peace Agreement and a Protocol of Accord are included as Appendices F and G.

3-1.3 Recipient Agency Agreement

If a CS intends to collaborate with another organization, agency, or association, or with the host country government (hereinafter referred to as a "counterpart") to address food insecurity in a country or region, the CS must execute a Recipient Agency Agreement with the counterpart before it transfers any Title II commodities, monetization proceeds, and/or program income to that counterpart.[22]

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[21] *Save the Children Monetization Implementation Manual: a How-to Manual on Implementing Monetization Projects in the Field*, Marine Overseas Services, Inc., February 1993, Section 3.2.
[22] Regulation 11 refers to counterparts as "recipient agencies," and defines the term as "schools, institutions, welfare agencies, disaster relief organizations, and public or private agencies whose food distribution or project activities are sponsored by the cooperating sponsor and which receive for distribution to eligible recipients commodities or monetized proceeds or program income for approved project activities." Regulation 11 further states that "a cooperating sponsor may be a recipient agency." 22 CFR Part 211, Section 211.2(t).

Regulation 11 states that the Agreement shall:

> (1) Describe the approved uses of commodities, monetized proceeds and program income in a manner consistent with the approved Operational Plan or TA;
> (2) Require the recipient agency to pay the cooperating sponsor the value of any commodities, monetized proceeds or program income that are used for purposes not permitted under the Recipient Agency Agreement or that are lost, damaged or misused as a result of the recipient agency's failure to exercise reasonable care with respect to such commodities, monetized proceeds or program income; and
> (3) Incorporate by reference or otherwise the terms and conditions set forth in . . . Regulation 11.[23]

A sample format for a Recipient Agency Agreement is included as Appendix H.

3-2 Title II Proposals: the Monetization Request

A monetization request is that portion of a Title II development, emergency, or transition proposal in which a CS seeks USAID's donation of agricultural commodities for purposes of selling the commodities in an overseas market to generate foreign currency proceeds to be used to pay administrative and/or programmatic costs associated with a Title II program. The following paragraphs describe and summarize the guidelines to be referenced when preparing a monetization request.

> A **monetization request** is that portion of a Title II development, emergency, or transition proposal in which a CS seeks USAID donation of agricultural commodities for purposes of selling the commodities in an overseas market to generate foreign currency proceeds to pay administrative and/or programmatic costs associated with a Title II activity.

FFP has issued three discrete documents to guide CSs in the preparation of Title II proposals. The CS must reference the DAP/PAA Guidelines when preparing a development-focused proposal; the requirements set forth in this document that specifically relate to preparing a monetization request for a development program are discussed below in Section 3-2.2. The CS must reference FFP's Emergency Guidelines when preparing an emergency or transition proposal; the requirements contained in this document that specifically relate to preparing a monetization request for an emergency or transition program are discussed below in Section 3-2.3. Finally, the CS must reference the *Monetization Field Manual* when preparing any Title II program proposal that includes a monetization request; the guidance contained in this manual for preparing a monetization request is discussed immediately below.

[23] *Ibid.*, Section 211.3(c)(1-3).

3-2.1 FFP's *Monetization Field Manual*: Guidance for Preparing a Monetization Request

The MFM provides explicit guidance on preparing the monetization request portion of a Title II proposal. It also informs the CS about the review and approval process to which all monetization requests are subject. *Note that all monetization requests, be they in support of development, emergency, or transition programs, must comply with the requirements outlined in the MFM.* The following paragraphs summarize and, in some cases, clarify the points made in the MFM regarding the development and review/ approval of monetization requests. This explication is not meant to substitute for the text of the MFM.

3-2.1.1 MFM–Developing a Monetization Request

The MFM is divided into two sections: the Policy Framework and the Implementation Guidelines. Section II of the Implementation Guidelines provides direction on how to draft a monetization request. The MFM recommendations for what to include in the request are summarized below.

Justification for Monetization–Section II.A.1-4 of the Implementation Guidelines

Section II Part A of the MFM Implementation Guidelines lists four justifications for monetizing. The CS must address "end-use justification" in all monetization requests, describing in detail the activities that will be supported with monetization proceeds. Note that FFP requires the CS to provide in its budget a breakdown of the estimated amount of proceeds that will be needed to support each activity component within a proposed program as well as a breakdown, by activity, of the amount and type of commodities that are being requested for direct distribution. The amount of food needed for direct distribution plus the amount of food needed to generate the budgeted foreign currency proceeds will determine the total tonnage required by the program.

The CS is also required to address the "cost recovery justification" in all monetization requests. The CS must discuss the cost-effectiveness of monetizing Title II commodities (i.e., the amount of funding to be made available for programming as compared to the costs incurred in carrying out the monetization) and state explicitly whether the sole objective of the monetization is to raise funds to support Title II activities. FFP requires that, in most instances, sales of Title II commodities meet, and preferably exceed, the cost recovery benchmark. This is defined as "80% of the C&F value, as quoted by FFP at the time of the call forward, plus port clearing and handling costs and duties, estimated transport costs to move the commodity to the point of sale, and expenses associated with marketing the commodity, or 100% of FAS, whichever is greater."[24] (Refer to the glossary for definitions of C&F and FAS.) If it does not anticipate that the planned monetization transaction(s) will meet or exceed the cost recovery benchmark, then the CS

[24] *Monetization Field Manual: P.L. 480 Title II Programs,* Office of Food for Peace (USAID), October 16, 1998, Section VII of the Policy Framework and Section I.C. of the Implementation Guidelines.

is expected to justify the monetization based upon its expected food security impact (see the next paragraph). Cost recovery is discussed in greater detail below and in Chapter 4.

Some CSs monetize as a response to food supply deficits in a country. In accordance with the paragraph on "supply justification" in the MFM, a CS who plans to monetize for this reason must identify the supply effects the monetization is expected to produce, including the anticipated impact of the additional food being supplied to the market and any anticipated effects resulting from the sales process. If the proposed commodity sales are not likely to yield sufficient proceeds to meet the cost recovery benchmark, then the CS should provide a detailed and compelling explanation of the expected impact of the monetization on food security. If the proposal is approved, the CS will have to submit a waiver request to the FFP/D at the time of a call forward if it still anticipates that the cost recovery benchmark will not be met. (See Section 7-2.2 in this manual for a discussion of waivers.)

A number of CSs monetize commodities in order to foster the development of local markets. By selling commodities in small lots and marketing commodities in rural, even remote, areas of the country, these CSs are able to attract small- and medium-sized buyers into the marketplace. When a CS is proposing to use monetization to broaden market participation, the "market development justification" section of the MFM requires the CS to describe the commercial environment in which it will be operating and the strategies it will use to increase participation as well as the targets it has set against which success can be measured.

<u>Preliminary Proposed Mechanics of the Monetization</u> - Section II.B.1-6 of the Implementation Guidelines

This section of the MFM tells the CS what information concerning commodity selection, commodity sales, and storage facilities to include in the monetization request. Note that the six items listed in this section are likely to be addressed in the Bellmon analysis. If they are, the CS should cross-reference the relevant section of the Bellmon analysis rather than repeat the discussion in the body of the monetization request.

<u>Monetization Sales Budget</u> - Section II.C. of the Implementation Guidelines

If a CS can demonstrate that monetization will have an exceptionally favorable impact on the food security of a country or region, it may be exempted from the requirement that its monetization transactions meet FFP's cost recovery benchmark. Otherwise, the CS is expected to meet or exceed the cost recovery benchmark in all sales transactions. (See paragraph 2 under "Justification for Monetization" for a definition of "cost recovery benchmark" as well as Section 7-2 of this manual for a discussion of cost recovery.) As early as in the initial monetization request, the CS is expected to report a preliminary cost recovery estimate for the commodity(ies) it is proposing to monetize. In the Monetization Sales Budget section of the MFM's Implementation Guidelines, FFP presents the formula for calculating the preliminary cost recovery estimate. This formula is reproduced below.

Note that the CS must make a separate calculation for each commodity it intends to monetize.

1. U.S. Commodity Price Indication ($/metric ton x tonnage requested);
[U.S. commodity price indications can be obtained from the Internet. (See Appendix I for a list of Internet sources of commodity price information.) Note that the Internet sources quote FOB prices; the cost of transporting the commodities to the port must be added to the FOB price in order to obtain the FAS price. Transportation costs to the U.S. port may be obtained from the CS's freight forwarding agent. Note also that the Internet may quote the price of a commodity in something other than dollars per metric ton; if so, the CS will need to make the necessary conversion. A conversion chart is provided in Section I.A.1 of the Implementation Guidelines of the MFM.]

2. Estimated Ocean Freight and Inland Transport for Landlocked Countries ($/metric ton x amount requested)
[Estimates of ocean freight and inland transport costs can both be obtained from the CS's freight forwarding agent. ***Special note: The Cargo Preference Act of 1954 requires that 75 percent of P.L. 480 commodities be shipped on a U.S.-flag vessel. Shipping rates for U.S. flag vessels are generally higher than those for foreign-flag vessels. In any commercial transaction, a shipper would hire the shipping line that offers the most competitive rates. Recognizing that monetization is essentially a commercial transaction, FFP therefore allows the cost recovery calculation to be based on foreign-flag vessel rates rather than U.S.-flag vessel rates.]***

3. Estimated Internal Transport to the Point of Sale, Duty, Handling, Port Clearing, and Marketing Costs, broken out by line item
[Internal transport costs are frequently included in the cost of inland transport; if not, the CS can obtain estimates from local transport firms in the host country. The host government will be able to provide information about any duties or import taxes to which a commodity is subject. Handling and port clearing charges are sometimes paid by the shipping company or the shipping company's agent. If they are not, the CS can obtain estimates from host country receiving and transit companies. If handling and port clearing costs are to be paid by the buyer, they should not be included in the cost recovery calculation.]

4. Base Costs (sum of 1-3 above)

5. Estimated Sales Revenue plus Expected Interest Earnings
[The Bellmon analysis that is submitted with the proposal should include prices obtained for recent sales of the commodity. Multiply the most conservative price by the tonnage being requested to obtain the estimated sales revenue. Add to the estimated sales revenue any anticipated interest earnings.]

6. Preliminary Cost Recovery Estimate
   [Divide #5 (the estimated sales revenue) by #4 (the total of all costs associated with acquiring, transporting, and selling the commodities).]

Special Note: The CS must report the preliminary cost recovery estimate in U.S. dollars. Therefore, it may need to convert some of the above calculations from local currency to U.S. dollar equivalents. Use the most recent conservative exchange rate available to make the currency conversions.

To comply with the cost recovery requirement, the CS's estimated sales revenue (#5) must equal or exceed either 100 percent of #1 or 80 percent of #4, ***whichever is greater***.

<u>Example 1</u>:

1. U.S. Commodity Price Indication = $245/MT
2. Estimated Ocean Freight and Inland Transport for Landlocked Countries = $85/MT (ocean freight should be based on foreign-flag carrier rates)
3. Estimated Internal Transport to the Point of Sale, Duty, Handling, Port Clearing, and Marketing Costs = $62/MT
4. Base Costs = $245 + $85 + $62 = $392/MT
5. Estimated Sales Revenue plus Expected Interest Earnings = $369/MT
6. Preliminary Cost Recovery Estimate = $369 ÷ $392 = .941

To comply with the cost recovery requirement, the CS must recover the ***greater of*** $245/MT (which is 100 percent of FAS) or $313.60 (which is 80 percent of C&F plus associated costs, i.e., 80 percent of #4). Since the estimated sales revenue of $369/MT exceeds the benchmark ($313.60/MT in this case), the sale complies with FFP's cost recovery requirement.

<u>Example 2</u>:

1. U.S. Commodity Price Indication = $400/MT
2. Estimated Ocean Freight and Inland Transport for Landlocked Countries = $65/MT (ocean freight should be based on foreign-flag carrier rates)
3. Estimated Internal Transport to the Point of Sale, Duty, Handling, Port Clearing, and Marketing Costs = $20/MT
4. Base Costs = $400 + $65 + $20 = $485/MT
5. Estimated Sales Revenue plus Expected Interest Earnings = $396/MT
6. Preliminary Cost Recovery Estimate = $396 ÷ $485 = .816

To comply with the cost recovery requirement, the CS must recover the ***greater of*** $400/MT (which is 100 percent of FAS) or $388/MT (which is 80 percent of C&F plus associated costs, i.e., 80 percent of #4). Since the estimated sales revenue of $396/MT is less than the benchmark ($400/MT in this case), the sale fails to meet FFP's cost recovery requirement.

If a CS has not received word from the host country government on whether or not it will be exonerated from paying duties and taxes on monetization commodities, it may wish to calculate one preliminary cost recovery estimate that includes taxes and another that excludes taxes, as in the example below.

***Example 3*:**

1. U.S. Commodity Price Indication = $245/MT
2. Estimated Ocean Freight and Inland Transport for Landlocked Countries = $85/MT (ocean freight should be based on foreign flag carrier rates)
3. Estimated Internal Transport to the Point of Sale ($40/MT), Duty ($16/MT), Handling ($2/MT), Port Clearing ($0/MT), and Marketing Costs ($4/MT) = $62/MT
4. Base Costs if Duty Must Be Paid = $245 + $85 + $40 + $16 + $2 + $4 = $392/MT

or

4. Base Costs if CS is Exonerated from Paying Duty = $245 + $85 + $40 + $2 + $4 = $376/MT
5. Estimated Sales Revenue plus Expected Interest Earnings = $305/MT
6. Preliminary Cost Recovery Estimate with Duty = $305 ÷ $392 = .778

or

Preliminary Cost Recovery Estimate without Duty = $305 ÷ $376 = .811

In this example, the CS will not fulfill FFP's cost recovery requirement if it is required to pay the duty. If, however, the host government exonerates the CS from payment of the duty, then the CS will meet the cost recovery benchmark.

Sales Proceeds Management - Section II.D. of the Implementation Guidelines

In accordance with Section II.D. of the Implementation Guidelines, a CS's proposal must include a section on managing the foreign currency proceeds that will be generated by the monetization. USAID is particularly concerned that the CS has a plan for protecting the proceeds from inflation in the host country or a devaluation of the host country's currency. In order to protect the value of the proceeds, USAID requires that they be deposited in an interest-bearing account. For further protection, the CS may elect to convert the funds to a hard currency. (See Chapter 12 for more information about managing monetization proceeds.)

USAID also expects the CS to be able to put in place financial and management systems that will allow safe implementation and accurate tracking of the receipt, disbursement, and expenditure of foreign currency proceeds. . These systems should have built-in mechanisms for safeguarding the asset(s). Ideally, the systems will have been designed by experts having extensive knowledge about the controls needed to prevent the misappropriation of cash. Note that Section III.C. of the MFM Implementation Guidelines requires the relevant Mission to certify the adequacy of a CS's financial and management systems. If there are shortcomings in these systems, the Mission has the authority to delay approval of a monetization request until corrective measures are taken, or reject the request outright if the deficiencies are significant.

If a CS is proposing an umbrella monetization, FFP requires information about the relationship between the umbrella agent (which may or may not be a CS) and the other CSs participating in the umbrella monetization. The CS must attach a copy of the umbrella monetization agreement to its proposal. In addition, it must "describe the organizational and management framework, including the allocation and disbursement processes, within which the umbrella monetization activity functions."[25] (Umbrella monetizations are covered in Chapter 6 of this manual.)

See Chapter 12 for more information about managing monetization proceeds.

3-2.1.2 MFM - Review and Approval of Monetization Requests

Review and Approval Process - Section IV.A. of the Implementation Guidelines

Section IV.A. of the MFM Implementation Guidelines states that monetization requests must be drafted in accordance with the guidance that is provided by FFP for preparation of all Title II proposals (i.e., the DAP/PAA Guidelines for development proposals and the Emergency Guidelines for emergency and transition proposals). Both the DAP/PAA Guidelines and the Emergency Guidelines include instructions for preparing monetization requests that are additional to the ones summarized above in Section 3-2.1.1. (See Sections 3-2.2, 3-2.3, and 3-2.4, below.)

Section IV.A. of the MFM also states that for multi-year programs, the CS must submit a new monetization sales budget and comprehensive budget as well as an updated Bellmon analysis to the Mission (in presence countries) and to FFP for review and approval. For development programs, which are generally multi-year programs, the CS will submit these new budgets and the updated Bellmon analysis with its PAA. The CS must submit a PAA annually over the life of the proposal. Guidelines for preparing PAAs (including the monetization request) are included in the DAP/PAA Guidelines, which are revised and issued annually by FFP.

Finally, this section of the MFM advises the CS that Mission/FFP approval of a monetization request indicates simply that the monetization is recognized as being "conceptually possible." Circumstances and/or market conditions may change between the time the proposal is approved and the time the commodities to be monetized are called forward. CSs are requested "to refine the proposed mechanics of the monetization and verify whether the anticipated sales price will meet the cost recovery benchmark."[26]

Review and Evaluation Criteria - Section IV.B. of the Implementation Guidelines

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[25] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section II.D(4) of the Implementation Guidelines.
[26] *Ibid.*, Section IV.A.

FFP will review monetization requests in the same way as it does proposals involving 100 percent direct distribution of commodities. Monetization requests must also, however, provide assurance (1) "that the monetization proceeds will be used to support activities that are expected to achieve demonstrable effects on food security, as defined by USAID's *Food Aid and Food Security Policy* paper and measured using approved indicators" [A list of approved indicators is included as an appendix to the annual DAP/PAA Guidelines and can be obtained from FFP.]; (2) "that the monetization will not create disincentives to local production or marketing of the commodity to be monetized or its substitutes" [The potential effects of monetization on local production and marketing of the commodity and its substitutes should be thoroughly examined in the Bellmon analysis.]; (3) "that the amount of currency to be generated in the monetization transaction(s) will meet or exceed the cost recovery benchmark."[27]This criterion may be waived in cases where a monetization is justified based on its anticipated food security impact.]

FFP notes finally that it will review all monetization requests, whether for 100 percent monetization or for some combination of monetization and direct distribution, using the same criteria.

3-2.1.3 MFM - Monetization in Emergency Situations

Title II commodities have only rarely been monetized to support emergency programs. The MFM provides the following guidance regarding monetizing in emergency situations.

> Monetization of food aid in emergency situations is normally supportive of (a) enhancing access to food by vulnerable groups, and (b) generating funds supportive of emergency food activities. Monetization of emergency food aid must be guided by the criteria set forth in Section VIII of [the MFM].[28] If the criteria cannot be satisfied due to the nature of the emergency, then the FFP/D must make the determination that the benefits of the specific monetization merit a waiver of the Section VIII criteria.
>
> In emergency situations, the monetization of food aid should demonstrate that monetization offers the best option for satisfying the nutritional needs of targeted vulnerable groups. Situations where monetization may be appropriate include small-scale sales in drought-affected villages where surrounding farm families cannot grow enough to support the non-farm community. Other situations may occur wherein small-scale monetization can facilitate the re-establishment of a distribution channel closed by war or natural disaster. Finally, the sale of food aid to cover costs of moving

[27] *Ibid.*, Section IV.B.1-3.
[28] Note that the section of the MFM that is referred to here is discussed above in the paragraph entitled "Review and Evaluation Criteria." Section VIII appears in the Policy Framework of the MFM and again in the Implementation Guidelines (as Section IV.B.).

commodities to targeted vulnerable groups may have a more effective and developmental effect than the direct expenditure of foreign currency.[29]

Given that monetizing commodities to support emergency programs is still a relatively new practice, CSs should consult with the local USAID Mission and FFP about their plans for initiating an emergency program that relies, in whole or in part, on monetization prior to expending funds to develop a proposal.

3-2.2 FFP's DAP/PAA Guidelines: Guidance for Preparing a Monetization Request

The annual DAP/PAA Guidelines refer the CS directly to the MFM for guidance on preparing a monetization request for a development proposal. In addition, the guidelines ask the CS to discuss projected Title III support.[30] If Title III monetization proceeds will be used for development programs, projects, or activities related to the proposed Title II program, the CS should indicate the amount of Title III proceeds (in U.S. dollars) that will be provided. The CS should describe the specific uses of the Title III proceeds and the nature of the relationship to the proposed Title II program, noting whether and to what degree the program, project, or activity is complementary to or integrated with the Title II program. Finally, the guidelines ask the CS to provide as part of the DAP a vehicle procurement plan that details the number, estimated cost, and timing of vehicle purchases that will be made using monetization proceeds over the duration of the program. The CS must update the plan annually in the PAA submission.

3-2.3 FFP's Emergency Guidelines: Guidance for Preparing a Monetization Request

Monetization requests that are part of an emergency proposal must comply not only with the provisions of FFP's MFM, but also with the provisions related to monetization that are set forth in Section 3.3.C.(3) of FFP's Emergency Guidelines.[31] The responses that the CS provides to address the requirements outlined in FFP's Emergency Guidelines may very well overlap with the responses the CS provides to address the requirements outlined in FFP's MFM. The CS should not restate information but rather structure the monetization request to satisfy both sets of requirements in the same section of the request.

With regard to monetization, the Emergency Guidelines state that the CS must identify:

- how it helps the targeted response

[29] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section IX of the Policy Framework.
[30] USAID has not sought funding for the Title III program for FY2000. The requirements set forth in this paragraph that relate to Title III will be relevant only if USAID reinstates the Title III program.
[31] The Emergency Guidelines are available from USAID's website at www.info.usaid.gov/hum_response/ffp/emerg.htm

Describe why monetization is appropriate for the particular situation and how the availability/expenditure of foreign currency will help to address the food insecurity at hand. Keep in mind the two paragraphs in the MFM concerning monetization in emergency situations (see Section 3-2.1.3 above).

- buyers/sales process
  Describe the expected purchasers of the commodities. Will they be individuals, small traders, parastatals, etc? Explain how, when, and where the commodity sale(s) will be conducted. Will sales be effected through auctions, tenders, and/or negotiations? How many sales will be conducted throughout the year? Will the commodities be sold at the port, in the capital or other large city, or in communities where food insecurity is greatest?

- sales price [see FFP Monetization Guidelines (meaning the *Monetization Field Manual*)]
  Estimate the sales price(s) that will be obtained for the commodity(ies) being monetized. Prepare the preliminary cost recovery estimate as described above in the section entitled Monetization Sales Budget.

- internal controls
  Describe the procedures and systems that will be implemented to ensure that receipt, disbursement, and expenditure of monetization proceeds will be safely carried out and accurately tracked. Also explain the checks and balances that will be put in place to safeguard against theft and misuse of the proceeds.

- use of proceeds (plus interest)
  Explain in the text of the monetization request how the proceeds and any expected interest earnings will be applied to the program. What activities and/or administrative costs will the proceeds and interest earnings support? Also include the monetization proceeds and interest revenues as part of the proposal's comprehensive budget.

- management/accounting capacity
  Describe how the monetization proceeds will be managed, e.g., deposited in an interest-bearing account, converted to a hard currency, etc. Explain who is responsible for managing the proceeds and who has the authority to disburse and/or expend them. Describe the system (manual or computerized?) used to account for the monetization proceeds. Note that the CS can readily combined its response concerning management/accounting capacity with its response concerning internal controls.

- disincentive analysis

Submit a Bellmon analysis in conjunction with any and all monetization requests, including those of an emergency nature.[32]

3-2.4 FFP's Transitional Activity Guidelines: Guidance for Preparing a Monetization Request

The guidance FFP has issued for preparing transition program proposals is included as Annex G of the Emergency Guidelines.

Proposals for transition programs that incorporate a monetization request must comply with the requirements that are outlined in the Implementation Guidelines of the MFM and discussed above in Section 3-2.1. In addition, the CS must submit "letters of support from the appropriate host government line ministries demonstrating acceptance of a monetization program in concept"[33] in conjunction with transition proposals.

Given that monetizing commodities to support transition programs is still a relatively new practice, before they expend funds to develop proposals, CSs should discuss with the local USAID Mission and FFP their plans for initiating transition programs that rely, in whole or in part, on monetization .

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[32] *PVO Guidelines for Title II Emergency Food Proposals*, Office of Food for Peace (USAID), Section 3.3(C)(3).
[33] *Ibid.,* Annex G, Section 2.I.

Chapter Four

PROPOSAL PREPARATION PHASE II: COMMODITY SELECTION AND PROGRAM BUDGET

After reading this chapter and/or receiving training in the chapter material, one should be able to:

- *describe five factors to consider when determining which commodity(ies) to include in a Bellmon analysis*
- *summarize the allowable uses of monetization proceeds specified in Regulation 11*
- *explain which development program expenses should be covered by monetization proceeds and which should be covered by 202(e) funds*
- *describe the procedures to be followed when a monetization transaction yields greater-than- or less-than-expected proceeds*
- *explain what is meant by the term "foreign currency pipeline"*

4-1 Commodity Selection

Commodity selection is a process that a CS engages in at two different points in time. First, the CS must select those commodities that it will include in its Bellmon analysis. These are the commodities that the CS has deemed to be potentially suitable for monetization, based on an initial investigation. The CS might compile this initial list of commodities at the time of the needs assessment or during the first stage of the Bellmon analysis. It will need to obtain more information about these commodities to determine whether they could be successfully monetized in a particular country, and thus will include them in the Bellmon analysis.

Section C.2. in Appendix B of the MFM suggests a methodology for identifying commodities that have the potential to be monetized in a country. Appendix B recommends that the CS ascertain:

- which food commodities are consumed in the host country;
- which of those foods are consumed by vulnerable people;
- which of the commodities consumed are typically part of the P.L. 480 food basket (A list of commodities that was available for use in Title II programs as of December 1998 is attached as Appendix J.)

Section C.3. of the Appendix explains how the commodities identified by answering these three questions can be "short listed" so that the Bellmon analysis can focus on those commodities that have the best chance of being successfully monetized.

The CS makes a second commodity selection after conducting the Bellmon analysis, at which point it decides which commodities will be programmed.

4-1.1 Selecting Commodities for the Bellmon Analysis

In addition to asking and obtaining answers to the questions listed above, the CS should consider the following points when making the decision about which commodities to include in the Bellmon analysis.

1) The CS must consider the types and amounts of commodities that are already supplied to the country by commercial exporters, other CSs, other U.S. government-funded organizations, multilateral organizations, and such non-U.S. donors as the European Union, Canada, and Australia, as well as the timing of these importations. No matter how food insecure a country is, it can absorb only limited food aid without local production and marketing being disrupted. This applies to both monetized and distributed food aid. The case study presented at the end of this chapter illustrates the importance of understanding local commodity markets when selecting a commodity for monetization.

2) CSs should identify any agricultural policies in the host country that are aimed at increasing production of a particular crop. If such policies are in place, the host government might impose an incremental increase in tariffs or duties in an effort to curb imports and promote local production of that crop.

3) Commodity producer and processor associations have been putting increasing pressure on FFP and CSs to comply with the legislated mandate that 75percent of non-emergency commodities be processed, bagged, and/or fortified. CSs should refer to the commodities list in Appendix 4.1 to become familiar with the spectrum of commodities that are available for programming.

4) Another important point to consider when selecting commodities to include in the Bellmon analysis is whether any prohibitions or restrictions have been placed on the importation of the commodities and whether any duties or import taxes have been imposed or are expected to be imposed. The CS must keep in mind that FFP requires that it recover the cost of any and all taxes and duties paid to the host government on the importation of monetization commodities.[34] This requirement could make achieving the cost recovery benchmark more difficult.

5) One final point the CS should consider when selecting commodities is availability. When a commodity is in short supply in the United States, USDA may prohibit or restrict its use in Title II programs. For example, corn has been available for Title II direct distribution programs but not for monetization. If a commodity is, or is expected to be, in short supply in the U.S., then the Cs should probably not rely on that commodity to support a monetization-funded program.

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[34] *Monetization Field Manual: P.L. 480 Title II Programs,* Office of Food for Peace (USAID), October 16, 1998, Section VI.C. of the Implementation Guidelines. In some cases (e.g., Kenya), the host government's in-kind contributions to the CS's program have been accepted as reimbursement for duties or taxes paid.

Special Note: In years past USDA published a "docket" that listed all the commodities that were available for Title II programming. USDA no longer publishes such a docket. CSs should contact FFP directly to find out whether any commodities being considered for programming are restricted or unavailable.

4-1.2 Establishing and Maintaining Contacts

An important step in the process of making informed commodity choices is to establish and maintain contact with the following individuals and groups: host country ministries[35], U.S./host country/regional producer and processor associations, USDA, the U.S. Embassy Agricultural Attaché, food aid donors other than USAID (the European Union, Canada, Australia, etc.), and other Title II CSs.

A list of U.S.-based commodity producer and processor associations is included in this manual as Appendix K.

4-2 Monetization Budgets

The monetization budgets that CSs submit with their Title II proposals are analyzed by FFP staff members to ensure that proposed costs are reasonable, allowable, and allocable and to ensure that costs are charged against the appropriate funding source, i.e., monetization proceeds, 202(e), or ITSH.

The MFM does not offer specific guidance on preparing budgets for monetization requests. However, FFP's DAP/PAA Guidelines provide comprehensive instructions on how to prepare budgets for development program proposals. Similarly, the Emergency Guidelines relay the budget information that must be included in an emergency proposal.

4-2.1 Allowable Uses of Monetization Proceeds

A CS in doubt about what use of monetization proceeds is allowable under a Title II program should first refer to Section 203(d) of P.L. 480. This section of the legislation gives an overview of the allowable uses of foreign currency. For more detailed guidance, the CS should next refer to Regulation 11. With regard to allowable uses of monetization proceeds, Section 211.5(k) provides somewhat more detailed guidance than does P.L. 480 but directs the CS to OMB Circular A-122[36] for more specific guidance. Regulation 11 states that:

> (1) Nongovernmental cooperating sponsors and recipient agencies may

Uses of Monetization Proceeds Approved under Regulation 11

- To cover costs of transport, storage, and distribution facilities, pest control, and salaries associated with these
- To finance income-generating, community development, health, nutrition, cooperative development, and agriculture projects
- To make investments approved by USAID
- To cover office costs in the activity

[35] The Ministry of Commerce has been a particularly important contact in a number of countries where commodities are being monetized.

36 OMB Circular A-122 is available on the Internet at: www.whitehouse.gov/WH/EOP/OMB/html/circulars/a122/a122.html

use monetized proceeds and program income to:

(i) Transport, store, distribute and otherwise enhance the effectiveness of the use of donated commodities and products thereof, including construction or improvement of storage facilities or warehouses, handling, insect and rodent control, payment of personnel employed or used by the cooperating sponsor or recipient agencies in support of approved programs;

(ii) Implement income generating, community development, health, nutrition, cooperative development, agricultural and other developmental activities agreed upon by AID and the cooperating sponsor;

(iii) Make investments, with the approval of AID, and any interest earned on such investments may be used for purposes described in paragraphs (k)(1)(i) and (ii) . . .;

(iv) Pay indirect costs of the cooperating sponsor that are allocable to the monetization program at the indirect cost rate approved by AID for the cooperating sponsor, the direct and indirect costs of an office maintained by the cooperating sponsor in the country where the monetization program is conducted that are allocable to the title II program there, and the costs of a regional office maintained by a cooperating sponsor that are allocable to the cooperating sponsor's effort to enhance the effectiveness of the use of commodities provided by AID under title II.

(2) Monetized proceeds and program income may be used by the cooperating sponsor and recipient agencies only for the purposes described in the Operational Plan or TA, and only for such costs as would be allowable under OMB Circular A-122, as amended, "Cost Principles for Nonprofit Organizations." A recipient agency may use not to exceed $500 per year of voluntary contributions for institutional, community or social development or other humanitarian purposes without regard to the Operational Plan or TA or OMB Circular A-122.

(3) [This section is applicable only to governmental cooperating sponsors.]

(4) Monetized proceeds may not be used to pay for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions.

(5) Except as AID may otherwise agree in writing, monetized proceeds may not be used to finance the production for export of agricultural commodities, or products thereof, that would compete in the world market with similar agricultural commodities, or products thereof, produced in the United States, if such competition would cause substantial injury to the United States producers, as determined by AID.

(6)(i) The cooperating sponsor shall use commercially reasonable practices in construction activities and in purchasing goods and services with monetized proceeds or program income; maintain a code of conduct regarding conflicts of interest; carry out procurement transactions in a manner to provide open and free competition to the maximum extent practicable; and maintain and make available to AID in accordance with Section 211.10 [of Regulation 11] records and documents regarding the procurement of goods and services with monetized proceeds and program income. Cooperating sponsors shall follow their own requirements relating to bid guarantees, performance bonds and payment bonds when program income or monetized proceeds are used to finance construction or the improvement of facilities, but shall consult with USAID or the Diplomatic

> Post regarding such requirements when the estimated cost of such construction or improvements exceeds $100,000. Title to real and personal property shall be vested in the cooperating sponsor, except as provided in the Operational Plan or TA or as AID may otherwise agree in writing, subject to the requirements of Section 211.11 [of Regulation 11] upon termination of the program.
>
> (ii) Monetized proceeds and program income may not be used to acquire, construct, alter or upgrade land, buildings or other real property improvements that are used in whole or in part for sectarian purposes or which are owned or managed by a church or other organization engaged in religious activity. Notwithstanding the preceding sentence, monetized proceeds or program income may be used to finance repair or rehabilitation of an existing structure owned or managed by a church or organization engaged exclusively in religious activity to the extent necessary to avoid spoilage or loss of donated commodities, provided that the structure is not used in whole or in part for any sectarian purpose while donated commodities are stored in it. The use of monetized proceeds or program income to finance construction of such a structure may be approved in the Operational Plan or TA or by USAID or the Diplomatic Post if the structure is needed and will be used for the storage of donated commodities for a sufficient period of time to warrant the expenditure of monetized proceeds or program income and the structure will not be used for any sectarian purpose during this period.

Note: Regulation 11 states that only those costs that are allowable under OMB Circular A-122, as amended, can be covered with monetization proceeds. The CS must, therefore, be very familiar with the provisions of this circular.

Finally, CS should also reference the DAP/PAA Guidelines to determine allowable uses of monetization proceeds.

4-2.2 Exchange Rates

All budgets that are submitted to FFP must be denominated in U.S. dollars. Therefore, the amount of foreign currency the CS expects to generate through monetization must be translated and reported in U.S. dollars. FFP does not provide guidance in the MFM regarding the choice of exchange rates. For budgets that appear in a development program proposal, the DAP/PAA Guidelines require that the CS "state the exchange rate used and an explanatory note regarding the choice of exchange rate, including the date it was obtained, the time period it reflects or other relevant information to place it into context."[37]

4-2.3 Funding Source: Monetization Proceeds vs. 202(e) vs. ITSH

FFP's DAP/PAA Guidelines include an appendix entitled "Section 202(e) Grant Instructions," which provides information about budgeting FFP cash resources for Title II development programs. The appendix emphasizes budgeting Section 202(e) funds; however, it also provides guidance on the use of monetization proceeds. Similarly, FFP's

[37] DAP/PAA Guidelines for FY2000, Chapter 3 Section V.A.2.

Emergency Guidelines provide guidance on the appropriate uses of monetization proceeds and Section 202(e) and ITSH funds.

4-2.3.1 Development Programs

The only U.S. dollar-denominated cash resource that a CS may seek in a Title II development proposal is Section 202(e) funding. Section 202(e) of P.L. 480 authorizes FFP to make available up to $28 million of cash resources to assist organizations in "(A) establishing new programs under [Title II]; and (B) meeting specific administrative, management, personnel and internal transportation and distribution costs for carrying out programs in foreign countries under [Title II]."[38] In the mid-1990s, FFP has allocated $10 million of the $28 million to the World Food Program. This has left FFP with $18 million to make available to CSs to cover country-specific programming costs for both emergency and non-emergency programs worldwide.

Because of the limited availability of 202(e) funds, FFP restricts their use. The "Section 202(e) Grant Instructions" document states that "Section 202(e) funding **<u>will not</u>** be approved for . . . costs that can be financed from other sources, such as Title II monetized proceeds . . ."[39] The CS must include any and all costs that can conceivably be paid for with foreign currency in its monetization budget rather than in its 202(e) budget. FFP carefully examines all DAP and PAA budgets to ensure that, wherever possible, expenses are budgeted to be paid with monetization proceeds rather than with scarce 202(e) dollar resources.

FFP is aware that this policy exacerbates the problem of "excessive monetization" that is discussed in Section 1-7 of Chapter 1. FFP has proposed to address the matter by requesting Congress to increase the ceiling on 202(e) resources from $28 million to $50 million. However, until the request is made and approved, the demand for 202(e) funds is likely to exceed the supply. FFP has elected to meet the demand for cash resources by requiring that monetization-funded programs generate sufficient foreign currency to cover all foreign currency-denominated expenses.

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[38] P.L. 480, Section 202(e).
[39] *Section 202(e) Grant Instructions*, Section III.

4-2.3.2 Emergency Programs

Emergency programs have access to another source of dollar funds in addition to 202(e) funds. These are known as ITSH (internal transport, storage, and handling). FFP has issued special ITSH Guidelines, which are attached to the Emergency Guidelines as Annex D. The ITSH Guidelines outline specifically the types of costs that can be covered with ITSH funds.

With regard to choosing between ITSH, monetization, and Section 202(e), the ITSH Guidelines state:

> 3.1. Monetization of Title II emergency commodities or the use of Section 202(e) funds may be preferred alternatives to a request for ITSH support or may supplement an ITSH request. Decisions between requests for monetization of emergency commodities, use of Section 202(e) funds, or the provision of ITSH funds for funding required to respond to elements of an emergency situation will be made by Food for Peace on a case-by-case basis in consultation with the Cooperating Sponsor. The general principles guiding these decisions will be which combination of funding minimizes the cost to the U.S. taxpayer, yet allows for an effective and efficient response to urgent and extraordinary relief needs.
>
> 3.1.a. . . . Food for Peace believes the use of Section 202(e) funds to cover offshore emergency support should be considered by Cooperating Sponsors. As well, the use of Section 202(e) funds for indirect in-country emergency program support may be considered by the Cooperating Sponsor.
>
> 3.2. Monetization. Food for Peace believes that monetization of a small portion of commodities, above and beyond that needed to feed targeted vulnerable groups, should be considered by a Cooperating Sponsor if monetization is a more cost-effective approach than the use of foreign exchange provided through ITSH or 202(e).
>
> 3.2.a. In a food deficit country, monetization that helps meet the food needs of targeted vulnerable groups, stabilizes food prices in the immediate village or camp, or reduces the costs of transportation and distribution, may complement or supersede requests for ITSH. Similarly, the need for ITSH could be reduced by monetization of small amounts of emergency commodities for the local procurement of seeds and tools to assist resettlement or reintegration or otherwise enable beneficiaries to end their dependence on donated food. Cooperating Sponsors should be cognizant that all monetization requests will need to include a Bellmon analysis aimed

> at analyzing the impact of monetization on the local market and normal trade relationships.[40]

The CS should be well acquainted with the ITSH Guidelines as well as with the Section 202(e) Grant Instructions document before it begins to prepare the budgets for a Title II emergency proposal.

4-2.3.3 Transition Programs

Sections 2.D., 2E., and 2.I. of the Transitional Activity Proposal Guidance indicate that transition activities may be funded with 202(e), ITSH, and monetization resources. The guidance further states that with respect to ITSH, this resource "should be viewed as a declining source as a country progresses along the relief and development continuum, with ITSH available only for emergency Title II commodities. Other areas of funding should be explored as a Transitional activity matures, such as mission funding, other donors, private resources and monetization."[41]

Note that the above guidance on the programming of cash resources for transition programs is not clear-cut. The CS should reference FFP's Section 202(e) Grant Instructions, which are included in the FY 2000 DAP/PAA Guidelines, for additional information about Section 202(e) funding. In addition, the CS may wish to contact FFP/POD directly for clarification on which type of funding would be deemed appropriate to cover the specific expenses the CS expects to incur.

4-2.4 Program Income

Regulation 11 defines program income as "gross income earned by the cooperating sponsor or recipient agencies from activities supported under the approved program during the program period, including, but not limited to, interest earned on deposits of monetized proceeds, revenue from income generating activities, funds accruing from the sale of containers, and nominal voluntary contributions by recipients made on the basis of ability to pay."[42]

Note that the monetization proceeds themselves are not considered to be program income.

Section 211.5(k) of Regulation 11, which is presented above in Section 4-2.1, conveys the approved uses of both monetization proceeds and program income. One point worth reiterating is that "monetized proceeds and program income may be used by the cooperating sponsor and recipient agencies only for the purposes described in the Operational Plan or TA, and only for such costs as would be allowable under OMB Circular A-122"[43] This means that the CS must include in its proposal budgets any

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[40] *PVO Guidelines for Title II Emergency Food Proposals*, USAID, Annex D, Section 3.
[41] *Ibid.*, Annex G, Section (2)E.
[42] 22 CFR 211, Section 211.2(s).
[43] 22 CFR 211, Section 211.5(k)(v)(2).

income, as defined by Regulation 11, that it expects to generate so that expenditure of that income can be approved by FFP.

4-2.5 Surplus of Monetization Proceeds

Section VIII.B.1. of the Implementation Guidelines in the MFM addresses circumstances in which a monetization generates more foreign currency than originally anticipated and budgeted for. In short, the CS must report on the surplus in its annual report to FFP and discuss in the report how the surplus funds will be incorporated into the activity plan. The MFM suggests the following possible uses for surplus funds: reduction in out-year commodity requirements, expansion of activities, or, in the case of an expiring program, transfer of surplus proceeds to another approved program. The MFM specifies that monetization proceeds that have been generated "above the level approved in the DAP/PAA budget, may not be utilized by the CS without the written approval of FFP/W."[44]

4-2.6 Shortfall of Monetization Proceeds

Section VIII.B.2. of the MFM's Implementation Guidelines specifies the actions a CS must take when a monetization transaction yields less proceeds than anticipated in the program budget. When a shortfall resulting from an unexpected fall in commodity prices is expected to have a negative programmatic impact (for example, the CS is forced to curtail activities to such an extent that targets will not be met), the CS must submit a written report describing the circumstances of the loss. The CS may request FFP to provide additional commodities to compensate for the shortfall, but these will only be approved if the CS's written report adequately justifies the request and if funding is available.

Note: The shortfall situation described above does not mean the CS is unable to meet the cost recovery benchmark. It simply means that commodity prices have fallen since the time the budget was prepared, and the CS would therefore be unable to generate the needed amount of foreign currency by monetizing the approved commodity tonnage level.

4-2.7 Foreign Currency Pipeline

"Foreign currency pipeline" means monetization proceeds that were generated but unspent during one fiscal year and that were thus transferred to the budget for the following fiscal year. According to the MFM, FFP allows CSs to carry forward enough foreign currency to cover five months' worth of program expenses from one fiscal year to the next.[45] For example, a CS proposes to conduct in June a commodity sale that will generate enough proceeds to sustain the program for the six months beginning July 1 and ending December 31. For a fiscal year of 10/1 - 9/30, this would be acceptable since only three months'

[44] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section VIII.B.2. of the Implementation Guidelines.
[45] *Ibid.*, Section VIII.C. of the Implementation Guidelines.

worth of currency (October, November, and December) is being carried forward from the prior fiscal year. A CS may carry forward more than five months' worth of foreign currency if it can justify to FFP the need to do so.

Case Study: Commodity Selection in Morocco–Which Class of Wheat?

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I. Introduction and Problem Statement

In June 1998, Catholic Relief Services (CRS) undertook a preliminary feasibility study in Morocco to determine the potential for a large-scale monetization in that country. CRS conducted a thorough market analysis, carefully analyzing a host of commodities available under the P.L. 480 Title II program: wheat, wheat flour, corn, barley, rice, vegetable oil, and milk. The study soon revealed that the most obvious commodity for monetization was bulk wheat, for two major reasons: 1) the role of wheat as a staple in the Moroccan diet; and 2) Morocco's status as a Low-Income Food Deficit Country (LIFDC), with annual wheat imports of over two million metric tons (MT). These factors, in addition to a governmental subsidy scheme that supported the price of wheat in the domestic market, all pointed towards a successful wheat monetization program. With this information, CRS prepared a concept paper for USDA's Section 416(b) program[47], requesting approximately 200,000 MT of bulk wheat to fund several projects in Morocco and in the West Africa region.

II. Proposal Preparation and Commodity Choice

In preparation for its full-fledged monetization proposal, CRS continued to update its analysis of the Moroccan cereal market. To this end, CRS monitored price changes in the international market, kept abreast of changes in the domestic tariff structure, and assessed domestic supply and demand for the upcoming year. CRS also worked in collaboration with U.S. Wheat Associates, who helped CRS to broaden its knowledge of the commercial wheat market. While much of this research confirmed CRS' earlier findings, the analysis also revealed a picture of two distinct wheat markets in Morocco. CRS quickly learned that the markets for U.S. soft and hard wheat differed in many respects,

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[46] The opinions expressed in this case study are solely those of the author, and do not necessarily represent the views of Catholic Relief Services.

[47] In July of 1998, President Clinton announced that 2.5 million MT of wheat would be made available for a humanitarian aid project, to be programmed through government-to-government programs, through WFP or through PVOs. In response to this announcement, CRS and other international agencies submitted concept papers to USDA outlining their potential uses of the wheat, either for direct distribution or for monetization. CRS initially submitted a concept paper for the monetization of 200,000 MT of bulk wheat in Morocco.

including preferences in domestic production, price subsidies, and import taxes. In particular, CRS learned that “soft” wheat (*blé tendre*) was the type of wheat that dominated local production, as well as commercial imports[48]; given the importance of this “soft” wheat in domestic cereal production, local producers were protected from lower import prices by a price support system and high import taxes. These extensive market controls were either minimal or non-existent in the market for hard wheat. As a result of these market regulations, hard wheat and soft wheat essentially functioned as two different commodities in the Moroccan market, with substantial differences in local prices and the quantities demanded. Considering these findings, CRS was forced to reassess the viability of its monetization proposal.

III. Redeveloping the Proposal and CRS/Morocco’s Solutions

The above findings showed that the Moroccan cereal market was more complex than originally thought, as well as highly differentiated according to the class of wheat. For this reason, CRS returned to its original feasibility study to conduct further research, focusing specifically on the U.S. classes of hard red winter (HRW) and soft red winter (SRW). This not only required CRS to revise its tonnage according to the class of wheat, but also to differentiate its cost recovery analysis and to accurately target the appropriate consumer for each commodity. For this reason, CRS sought out the support of U.S. Wheat Associates, an organization with detailed knowledge of wheat consumption patterns and prices in the Moroccan market. The in-depth analysis revealed that soft wheat imports depended primarily on price rather than quality differentiation; consequently, CRS concluded that any monetization of SRW wheat would be highly dependent on the prices of other non-U.S. imports. At the same time, CRS learned that a niche market existed for hard red winter wheat, with a market more appreciative of quality. For this reason, importers were willing to pay a dollar premium for U.S. HRW wheat. Nevertheless, the size of the import market for HRW was significantly smaller than that for SRW, comprising less than 15 percent of wheat imports for the previous year.

With a more detailed understanding of the Moroccan wheat market, CRS was able to recognize the need for a monetization proposal addressing both the hard wheat and the soft wheat markets. CRS therefore decided to develop its proposal targeting both commodities. At the time this case study was written, CRS was still developing its monetization proposal. Despite the delay, submitting a proposal for both commodities will allow CRS to respond to changes in the domestic and/or international wheat markets. For example, while a variety of factors in 1998/99–lower-quality French wheat, a revised import tax structure, and limited availability of high protein SRW wheat from USDA–suggested that the monetization of HRW wheat would be more competitive in the short term, CRS recognizes that some or all of these factors could change in upcoming years. The experience has therefore enabled CRS to appreciate the importance of differentiating wheat classes at the time of the feasibility study, in order to allow for sufficient time to assess the viability of a monetization proposal.

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[48] Although wheat produced outside of the U.S. does not conform to U.S. wheat classifications, the locally-produced *blé tendre* in Morocco closely resembles U.S. SRW wheat, as distinct from the locally-produced *blé dur*, which is durum wheat. Non-U.S. wheat imports into the Moroccan market more closely resemble U.S. SRW wheat.

Chapter Five

CONDUCTING THE BELLMON ANALYSIS[49]

After reading Chapter 5 and/or receiving training in the chapter material, one should be able to:

- *describe the professional qualifications of the person(s) conducting the Bellmon analysis*
- *cite the documents that provide guidance on conducting the Bellmon analysis*
- *cite the two components of the Bellmon analysis*
- *list at least eight items of information to be included in the disincentive analysis*
- *discuss the issues to be addressed in the storage analysis*

5-1 Overview of the Bellmon Analysis

In 1977, Congress adopted the Bellmon Amendment to P.L. 480 in response to concerns over the potential disincentive effects of U.S. food aid on agricultural production and marketing in recipient countries. The amendment stipulates that: 1) adequate storage facilities will be available in the recipient country at the time of the arrival of the commodity to prevent the spoilage or waste of the commodity; and 2) the distribution of the commodity in the recipient country will not result in a substantial disincentive to or interference with domestic production or marketing in that country.[50] Any P.L. 480 distribution or monetization program must fulfill these criteria in order to make a positive Bellmon Determination.[51]

Before a Bellmon Determination can be made, a Bellmon analysis must be undertaken in the country where food aid will be distributed or monetized.[52] The analysis must address the provisions of the Bellmon Amendment, and is therefore comprised of two separate components: 1) the disincentive analysis; and 2) the storage analysis. This chapter focuses on the procedures for conducting a Bellmon analysis.

5-2 Existing Guidance for Conducting Bellmons

Since 1977, USAID has issued several documents offering guidance on conducting the Bellmon analysis. The first was the 1985 *Background Paper and Guide to Addressing Bellmon Amendment Concerns on Potential Food Aid Disincentives and Storage*. The

[49] This chapter was prepared by Jenny C. Aker, Regional Food Security and Monetization Advisor for Catholic Relief Services in West Africa. The views expressed in this chapter are solely those of the author and should not be attributed to Catholic Relief Services. Additional information was gleaned through interviews with Stephen Sposato, Chief Economist, USAID/BHR/PPE.
[50] P.L. 480, Section 403 (a).
[51] The details of the Bellmon Determination and its certification are discussed in Section 2-5.1.
[52] In the case of a third-country monetization, a Bellmon must be carried out for each country where commodities are to be monetized.

paper discusses issues that need to be addressed in a Bellmon analysis and offers general guidelines for conducting Bellmons.

With the publication of the new *Monetization Field Manual* in 1998, however, FFP felt that the Bellmon guidance needed to be updated. Appendices A and B of the MFM provide guidance on preparing the disincentive analysis component of the Bellmon. Additional guidelines for Bellmon preparation are also available in FFP's annual DAP/PAA Guidelines.[53]

Despite the guidance that these documents provide, Bellmon analyses have varied in quality and content.[54] In response to this situation, Catholic Relief Services, in collaboration with Food for Peace/West Africa, developed draft guidelines for conducting Bellmons in the West Africa region. A copy of these guidelines is attached as Appendix 5.1 of this manual.

5-3 Who Conducts the Bellmon Analysis?

According to the MFM, the Bellmon analysis is primarily the responsibility of the CS, unless a Bellmon already exists for the current market year. The CS must therefore rely on either outside technical assistance or its own technical advisors. In some cases, USAID has provided financial and/or technical assistance for conducting Bellmons, particularly in countries receiving significant quantities of food aid, including Title III.

As outlined in Sections 5-4 and 5-5, the Bellmon analysis addresses a wide range of economic, agricultural, and marketing issues related to the agro-food system. In order to conduct this analysis, the CS must select an analyst with the appropriate qualifications: in general, a background in agricultural economics and/or agronomy and some experience with food aid programs. Even if a CS hires an outside analyst, the CS's participation in the analysis can be invaluable. Often the local CS office can offer important insights into local commodity markets, and logistical staff can help carry out the storage analysis.

5-4 Conducting the Bellmon Analysis: The Disincentive Analysis[55]

As mentioned in Section 5-1, the Bellmon analysis is divided into two separate components: the disincentive analysis and the storage analysis. The disincentive analysis must demonstrate that the distribution or importation of P.L. 480 commodities will not result in a substantial disincentive to or interference with domestic production or

[53] FY2000 DAP/PAA Guidelines, Information Packet.
[54] USAID/BHR/FFP. *Background Paper and Guide to Addressing Bellmon Amendment Concerns on Potential Food Aid Disincentives and Storage.* July 31, 1985. p. 3.
[55] The CS can find much of the data for the disincentive analysis from existing reports and secondary sources published by USAID and USDA; multi-lateral organizations such as the World Bank, the International Monetary Fund, the FAO and the World Food Programme; other bilateral and multilateral donors; host country government ministries; and USAID's Famine Early Warning System (FEWS). The CS can also obtain information through interviews with USAID officials, U.S. Embassy Agricultural and Commercial Attachés, and producers, traders, processors, and government officials in the host country.

marketing in the recipient country. The key issue for the analysis is not *whether* P.L. 480 commodities will have an effect on the market, but rather the magnitude of that effect.

The disincentive analysis must examine a wide range of issues related to the functioning of the agro-food system (the case study at the end of this chapter illustrates this important concept). Understanding this system and the potential impact of food aid on it can be difficult. Although the level of analysis for a Bellmon will vary according to individual markets, the volume of food aid, and available data, certain central issues must be addressed in all Bellmons.[56] These issues are outlined in Section 5-4, which provides an overall framework for conducting the disincentive analysis. Section 5-5 discusses the requirements for the storage analysis portion of the Bellmon.

5-4.1 Commodity Selection

As discussed in Section 4-1, commodity selection is one of the first steps in conducting the disincentive analysis. Often it is not practical or feasible to analyze the entire agro-food system, and therefore the analyst should focus on those commodities that have the best chance of being successfully monetized. Several cursory questions, as outlined in Section 4-1 and Appendix B of the MFM, can help to narrow the list.

- Which foods are consumed locally?
- Of these foods, which are imported to meet consumption needs?
- Are these foods available through the P.L. 480 program?

Answers to these questions at the outset can help short-list commodities to be included in the disincentive analysis. While the analyst will need to consider other factors, such as Congressional mandates, commodity specifications, and local restrictions, these questions can help focus the initial analysis.

5-4.2 Country Overview

To place the agro-food system in a broader context, the disincentive analysis should begin with an overview of the country's socioeconomic situation. The overview should provide information on Gross Domestic Product (GDP) per capita, land mass, principal sectors of economic growth, health and nutrition indicators, and the country's ranking in UNDP's Human Development Index. The analysis should also verify whether the country is classified as an LIFDC. The LIFDC classification is particularly relevant in Bellmons for third-country monetizations since FFP gives preference in its approval of third-country monetizations to commodity sales conducted in LIFDCs.

5-4.3 Agricultural Sector Overview

[56] The 1985 *Background Paper* suggests that the depth of analysis will depend upon the relative significance of P.L. 480 food aid as compared to total staple food consumption.

Following the country overview, the disincentive analysis should include a brief analysis of the agricultural sector. Since the main purpose of the Bellmon is to examine the impact of P.L. 480 food aid on local production and marketing, a solid understanding of the host country's agricultural system is crucial. The agricultural sector overview should include the following information:

- primary food and cash crops produced in the country
- main patterns of agricultural production, such as subsistence farms, commercial farms or foreign-owned plantations
- general production characteristics of the agricultural sector by agro-climatic zone, such as average farm size, access to farm inputs and technology, prevalence of rain-fed vs. irrigated agriculture, average crop yields, and harvest periods
- susceptibility to drought and other natural disasters
- average production of staple and non-staple food crops, including the percentage of consumption needs met by local production
- major strengths and/or weaknesses in agricultural production (comparative advantage)
- intra-annual prices of staple food crops

While the above list is not all-inclusive, it provides a wealth of information on the agro-food system. General characteristics of the agricultural sector, such as farm size, access to inputs, prevalence of rain-fed agriculture, and average crop yields, will indicate how responsive local producers are to price changes.[57] This responsiveness is an important factor for determining whether food aid will cause a disincentive to local production. For example, if farm sizes are relatively small, depend heavily on rain-fed agriculture, and lack access to inputs, domestic production is probably relatively inelastic; in other words, producers are less sensitive to price changes. If production is inelastic, the disincentive effects from additional P.L. 480 food aid will be minimized.

5-4.4 Government Policies Affecting the Agro-Food Sector

Following the agricultural sector overview, the disincentive analysis should examine the policy environment in the host country. Government policies have a profound impact on production, consumption, and marketing decisions. While this section will contain some information that overlaps with the information collected for the agricultural sector overview, it should offer more detailed information on the policy environment. Information should be collected on three main areas:

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[57] Responsiveness to price change is also known as elasticity. The price elasticity of supply measures the percentage change in the quantity supplied in response to a percentage change in prices. If local production is extremely elastic (or responsive), a small price change on the local market will result in a large percentage change in local production.

1) Pricing policies

In this section, the analysis should examine how food prices are determined in the host country. For example, are prices administered or are they determined freely? In order to make this determination, the analysis should look at the existence of administered prices for agricultural commodities, consumer subsidies, duties, and tariffs. The existence of stiff trade barriers can be interpreted as an effective ban on imports.

2) Marketing system

The second section should analyze the government's role in the marketing and distribution of food commodities, especially for those commodities that are in direct competition with P.L. 480 commodities. The analysis should determine whether there are parastatals or government-owned satellites that control a particular food sector, and should also comment on the role of the private sector in the marketing of food commodities.

Gathering data on the government's role in the marketing system makes it easier to understand how food is channeled throughout the economy, and also to determine whether public marketing institutions inhibit private sector trade and free market prices.

3) Agricultural policies

The final section should examine the government's policies in the agricultural sector. While this section will contain some information that overlaps with the information provided in the agricultural sector overview, it should analyze the level of government investment in the agricultural sector in addition to the government's involvement in the promotion and marketing of certain crops.[58] For example, if a host country has a stated policy to increase its self-sufficiency in rice, then the monetization of P.L. 480 rice would be in direct competition with these objectives. At the same time, it is important to determine whether other multi-lateral organizations, such as the FAO, the World Bank and the IMF, are encouraging specific policies in the agricultural sector.

5-4.5 Assessing Disincentive Effects for Individual P.L. 480 Commodities

Having provided background information on the agricultural sector and the policy environment, the disincentive analysis should next address potential disincentive effects for each of the P.L. 480 commodities under consideration. Before looking at specific commodity markets, the analysis should describe the typical food basket of the country, and state whether domestic production is sufficient (on average) to meet consumption needs.[59]

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[58] A host country's policies concerning the promotion of certain food and cash crops can be determined either through stated policies or through the observation of subsidies, duties, and other trade barriers.

[59] This information can be found in the FAO's *Food Balance Sheets* or FAO/GIEWS. FAO/GIEWS is the Food and Agriculture Organization's Global Information and Early Warning System, which provides

This section should then analyze potential disincentive effects for each P.L. 480 commodity. The analysis should pose the following question: Will the importation and sale of P.L. 480 commodity X cause a disincentive to local production and/or marketing? Attention should also be given to the accepted methods of conducting sales so that the manner in which the CS monetizes will not run counter to existing marketing channels and systems. The four main issues that should be addressed in this section are:

1) Consumption: What are the total annual consumption requirements for commodity X?

In order to understand the importance of a commodity in the host country, the analyst should gather information on its consumption. Consumption requirements can be calculated from historical consumption data or derived from the consumption of commodity X as a percentage of daily caloric intake. While these calculations will not reflect consumption differences based upon income levels, geographic regions, and individual preferences, they offer an estimate of national needs and demand.

This section should also provide information on the price elasticity of demand and the income group that typically consumes this food.[60]

2) Impact on domestic production:

a) Will the importation and sale of P.L. 480 commodity X cause a significant disincentive to the local production of commodity X?

To address this question, the analysis should look at such factors as the elasticity of local production and structural food deficits. If, as an example, domestic rice production is relatively inelastic and unable to meet domestic requirements, the potential for disincentive effects from a P.L. 480 rice monetization will be minimized.

This section should also compare local rice prices with prices for imported rice. Consistently higher prices for imported rice than for local rice suggest that imported rice is not undercutting local rice prices. If P.L. 480 rice is sold at the same price as imported rice, the potential for disincentive effects will be reduced.

b) Will the sale of P.L. 480 commodity X cause a significant disincentive to local production of other staple foods?

This question focuses specifically on the domestic production of commodities that are close substitutes for the P.L. 480 commodity. For example, wheat is not grown in the

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regular bulletins on food crop production and markets at the global level and situation reports on a regional and country-by-country basis. For more information refer to www.fao.org/giews.

[60] For more information on price and income elasticity, consult Timmer, Peter, Walter P. Falcon and Scott Pearson. *Food Policy Analysis.* Baltimore: Johns Hopkins University Press, 1983.

coastal countries of West Africa, but this does not necessarily mean that the importation of P.L. 480 wheat will not cause a disincentive simply because wheat is not produced locally. The analysis must examine the potential effects of a wheat monetization on locally produced substitutes.

To make this determination, the analysis should look at two factors: 1) the degree of substitution between commodities and 2) the elasticity of supply for locally produced substitutes. In the case of wheat, the analysis should first determine whether there are close substitutes for wheat in the local market. This can often be determined by looking at the country's typical food basket. If rice is a substitute for wheat, then the analysis should assess the degree of substitution between wheat and rice.[61] This is an important consideration because if the price of wheat falls, consumers will switch from local rice to wheat, thereby lowering domestic rice prices. Although the degree of substitution is measured by the cross-price elasticity of demand, a comparison of wheat and local rice prices can be used as a proxy. If wheat is more expensive than local rice, for example, then substitution between the goods (based on price alone) will be minimized.

If concerned that the degree of substitution is high, the analyst should also look at the elasticity of supply for rice. If local rice production is inelastic, producers would be less responsive to price changes. Thus, even if a P.L. 480 wheat monetization encourages a shift towards wheat consumption, local rice production will not change substantially. In this case, there would be fewer disincentive effects from a wheat monetization.

4) Impact on domestic marketing: Will the sale of P.L. 480 commodity X interfere with commercial marketing?

The disincentive analysis must also prove that P.L. 480 commodities will not interfere with commercial marketing. This specifically refers to the domestic marketing system, although it can also encompass the Usual Marketing Requirements (UMR) provisions of P.L. 480.[62] While this section should ideally address both of these issues, the UMR analysis is not included in the Bellmon Amendment. For this reason, a separate discussion of the UMR appears in Section 5-7.

In order to determine the impact of P.L. 480 commodities on the domestic marketing system, the CS's analysis should provide information on the marketing sector. In general, this section should determine the effectiveness of local marketing institutions and agents in transforming and transporting commodities. The analyst should therefore collect information on the marketing channels for the relevant food commodities; the overall competitiveness of the marketing system (i.e., number of participants); marketing costs, margins and profits; and international and domestic prices. This will indicate the efficiency

[61] This is known as the cross-price elasticity of demand, which measures the percentage change in the quantity demanded for commodity X in response to a percentage change in the price of commodity Y.
[62] The UMR requires that P.L. 480 commodities will not unduly disrupt world commodity prices or normal patterns of commercial trade.

of the marketing system, and thus the potential disruption from the sale of P.L. 480 commodities.

To strengthen this analysis, it is useful to construct a food balance sheet for the P.L. 480 commodity. Essentially, food balance sheets show whether total domestic supply, either from local production, commercial imports, or food aid, meets domestic demand (consumption).[63] To calculate the food balance sheet, the analyst needs information on average national consumption, net production, commercial imports, and food aid, based on historical time-series data for the past five years. Estimated data for the current year should also be included.[64]

If the food balance sheet reveals that supply falls short of requirements, this suggests that there is a supply shortfall (or unmet need) in the local market. If so, P.L. 480 food aid could fulfill this need without displacing current commercial imports or disrupting the marketing system.[65] The shortfall can also be used to determine the volume of monetization commodities. For example, a monetization tonnage that is less than or equal to the shortfall will lower the risk of disrupting commercial imports.

5-5 Conducting the Bellmon Analysis: The Storage Analysis[66]

The Bellmon Amendment also requires adequate storage facilities in the recipient country to accommodate the importation of food aid. The storage analysis should not only cite the tonnage capacity of storage facilities available, but also examine the port and transportation facilities. The analysis should collect the following information:

- Port facilities: What is the major port (or ports) of entry? What are the port's handling capacity and physical facilities? Are there problems with congestion?

- Storage facilities: What is the total storage capacity available in the recipient country, including public and private facilities and those owned by other PVOs and WFP? Are storage facilities available outside of the port area?

- Transport facilities: What is the state of transport facilities (roads, railways, and waterways) in the country?

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[63] When collecting data on total supply, the analyst should pay special attention to the role of food aid in the economy. Food aid data should be collected on the quantities of food aid from U.S. and other donors, the timing of shipments, and its programming uses (i.e., distribution or monetization).
[64] Calculating a food balance sheet for a five-year period allows the CS to look at trends in the local marketing system and to determine average levels of imports, production, and supply.
[65] Fulfilling an "unmet need" further minimizes potential disincentive effects on local production and marketing. If food aid is not additional in nature, then depressing price effects are less likely.
[66] USAID. *Background Paper and Guide to Addressing Bellmon Amendment Concerns on Potential Food Aid Disincentives and Storage*.

5-6 Updating the Bellmon Analysis

Although a Bellmon analysis might support a positive determination at one point in time, agro-food markets are constantly changing systems. The CS should therefore monitor market conditions on an ongoing basis, collecting information on wholesale and retail prices, import and production levels, and government policies. Consequently, the CS may need to update or re-draft a Bellmon during the course of a year if circumstances change significantly.

For multi-year programs, FFP requires that the Bellmon analysis be updated annually. The FY2000 DAP/PAA Guidelines state that, with regard to updated Bellmons, "CSs should . . . provide a very brief statement regarding the summary conclusions, relevant issues or areas of concern, and plans to ensure they are mitigated or resolved. If applicable, an updated Bellmon analysis which reflects new or changed commodity requirements should be submitted as an appendix to the PAA [or DAP Amendment]."[67]

Finally, in cables sent to FFP confirming Mission or Diplomatic Post approval of a CS's call forward, the principal officer of the Mission/Diplomatic Post must reaffirm that adequate storage facilities will be available in the recipient country and that the importation of the commodities will not result in a substantial disincentive to or interference with local domestic production or marketing.

5-7 Usual Marketing Requirements

The term "usual marketing requirements" (UMR) refers to the section of P.L. 480 that states: "In carrying out this Act, reasonable precautions shall be taken to safeguard the usual marketings of the United States to avoid displacing any sales of the United States agricultural commodities that the Secretary or Administrator determines would otherwise be made."[68] Simply stated, this means that P.L. 480 food commodities must not displace commercial exports of the United States. Other sections of the legislation contain related stipulations, notably: ". . . reasonable precautions shall be taken to assure that sales or donations of agricultural commodities will not unduly disrupt world prices for agricultural commodities or normal patterns of commercial trade with foreign countries."[69]

FFP will coordinate with USDA and the Department of State to determine whether the importation of P.L. 480 commodities will contravene UMR. CSs can assist by asking the cognizant Agricultural Attaché what the status is of the existing UMR analysis and whether it needs to be updated.

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[67] FY2000 DAP/PAA Guidelines, Chapter 5, Section IV.
[68] P.L. 480, Section 403(h).
[69] *Ibid.*, Section 403(e).

Case Study ("Best Practice"): Relying on Local Knowledge for the Bellmon Analysis in Ghana

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I. Introduction

Since 1987, Catholic Relief Services (CRS) has monetized P.L. 480 Title II bulk wheat in Ghana to generate proceeds for its development programs. As a result of this monetization experience, CRS/Ghana has developed in-depth knowledge of the local wheat market. While this knowledge has been beneficial to CRS/Ghana throughout its wheat monetization program, it was especially important in 1998.

In that year, USAID/Ghana determined that it needed an updated feasibility study to reassess the levels of food aid that could be monetized without creating a disincentive to local production. Since several nongovernmental organizations (NGOs) in Ghana were dependent on the monetization of wheat, the findings of this updated study were crucial to the future of their programs.[71] Before finalizing the market analysis, the local mission shared a draft copy of the report with CRS. The draft concluded that wheat was no longer suitable for monetization, citing the insufficient capacity of the local mills and the low levels of wheat imports. This report had serious implications for the future of Title II programming, since few alternatives existed in Ghana for monetization.

II. Knowing Your Operating Environment: The Importance of Local Knowledge for the Bellmon Analysis

After reading the draft report, CRS/Ghana contacted the local USAID Mission to discuss the Bellmon analysis. These discussions revealed that the consultant had found it difficult to get accurate information on the wheat market, and that figures from government ministries were often inaccurate and unreliable. Without other official sources, the consultant relied on statistics provided by government ministries for the Bellmon analysis. With years of experience in monetizing Title II wheat, CRS/Ghana knew that the figures reported in the study were inaccurate. In spite of this informal knowledge, CRS/Ghana realized that it would need documented facts on the wheat market to support its assertions.

[70] The opinions expressed in this document are solely those of the author and do not necessarily reflect the views or opinions of Catholic Relief Services.
[71] As of 1998, a four NGOs--CRS, TechnoServe, ADRA and OICI--monetize approximately 50,000 MT of bulk wheat in Ghana.

To this end, it collected data from governmental and nongovernmental channels, talking to local wheat millers as well as officials in government ministries. Using its knowledge of the operational environment, CRS/Ghana was able to collect market statistics that reflected more accurately the commercial operating environment. This import data was given to the Food for Peace Officer at the local Mission to supplement the data in the market study.

After receiving the additional data, the consultant revised the Bellmon analysis accordingly. The additional information had a profound impact on the eventual conclusions of the Bellmon analysis. Whereas the draft report had found that wheat was no longer feasible for monetization, the final report concluded that up to 50,000 MT of bulk wheat could be monetized in the local market without causing a disincentive to local production or disrupting local imports. This experience reaffirmed the importance of local knowledge in the Bellmon analysis, as well as the importance of communication between PVOs and the local Mission in all phases of the monetization process.

Chapter Six

UMBRELLA MONETIZATION

After reading Chapter 6 and/or receiving training in the chapter material, one should be able to:
- *define the term "umbrella monetization"*
- *list three advantages and three disadvantages of conducting an umbrella monetization*
- *describe the roles and responsibilities of the umbrella monetization committee*
- *list at least four provisions that should be included in an umbrella monetization agreement*
- *describe the roles and responsibilities of the umbrella monetization agent*

6-1 Definition of Umbrella Monetization

When two or more CSs implementing Title II programs in the same country or region collaborate to monetize their donated commodities jointly, they are carrying out an umbrella (or joint) monetization. The parties to an umbrella monetization are equal partners who come together solely for the purpose of marketing and selling Title II commodities in a coordinated manner. No one party to the umbrella monetization has control over the programming of the other parties' proceeds. USAID strongly encourages CSs to conduct umbrella monetizations. However, the MFM also states that USAID will not deny a CS's request to monetize individually as long as the CS can identify the benefits of conducting an individual monetization.[72]

6-2 Advantages of Umbrella Monetizations

The MFM cites numerous benefits to be realized from carrying out umbrella monetizations.

- Marketing costs and expenses related to analyzing markets are minimized.

- Duplication of effort on the part of multiple CSs is averted, which is likely to free up resources.

- The ability of CSs to negotiate more competitively in the marketplace is strengthened.

- The potential for achieving supply impacts is enhanced by the expertise gained by the lead agent. (See Section 6-6.1 below for a discussion of the role of the lead agent.)

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[72] Two or more CSs are operating in a country but programming different commodities should form an umbrella monetization committee to provide a forum for discussion about market, production, and other conditions in the country. However, the CSs would sign an umbrella monetization agreement and select a lead agent at their discretion.

- Umbrella monetizations allow for advantageous timing of commodity arrivals since each CS is not required to generate funds only from its own call forward. (Under an umbrella monetization, commodities are called forward and sold, and a percentage of the proceeds is distributed to each CS in accordance with the size of its program.) All activities require funding from the outset, and if CSs were to monetize individually, each CS would have to receive and sell commodities early in each fiscal year. The result could be a large influx of supply concentrated in a narrow time frame and consequently lower sales prices for the Title II commodities. Additional problems could occur if this time frame corresponds with the local harvest of the commodity being programmed. By avoiding this situation, umbrella monetizations can also help to stabilize markets.

6-3 Disadvantages of Umbrella Monetizations

A CS may decide to monetize individually because in some circumstances the disadvantages of conducting an umbrella monetization may outweigh the advantages.

- A CS that subscribes to the philosophy that commodities should be monetized in a way that induces markets to open up and become more competitive may have to compromise its position if it wishes to monetize with other CSs whose primary goal is to generate foreign currency proceeds.

- Participants in umbrella monetizations have to agree on who will act as the lead agent.

- A CS who has extensive experience monetizing Title II commodities may not wish to concede the role of lead agent to another CS.

- Carrying out a successful commodity sale requires a specific set of skills. CSs who monetize jointly lose the opportunity to acquire or hone these skills if they are not selected to be the lead agent.

6-4 Umbrella Monetization Committee

The MFM recommends establishing an umbrella monetization committee in countries where two or more CSs are implementing Title II programs, even if they do not intend to monetize jointly. The MFM is silent about the responsibilities of the committee, but does state that each of the CSs must be represented, as must the USAID Mission (preferably by the Food for Peace Officer), and any other individuals with monetization or market expertise. A CS may be represented by more than one person (e.g., the country director, the food security programming manager, the monetization manager, etc.) Nevertheless, each CS usually has only one vote in matters that are brought to a vote. According to the MFM, USAID participates in an ex-officio capacity and therefore is not allowed to take part formally in the Committee's decisionmaking.

The duties assigned to the umbrella monetization committee will vary from country to country. Listed below are some of the responsibilities the committee might assign to itself.

- Elect an administrative chairman. The CS that acts as the chair is responsible for organizing and facilitating committee meetings. This role may be assigned to a CS that is not acting as the lead agent. The committee may decide that this position is to rotate so that the CS who is hosting a committee meeting will act in the capacity of administrative chairman.

- Decide who will draft the umbrella monetization agreement and then approve it.

- Select the lead agent.

- Determine how the proceeds from monetization sales will be distributed.

- Develop the scopes of work for any consultants that are hired to conduct Bellmon analyses, research current and expected market conditions, carry out commodity sales, etc.

- Approve the provisions that will be included in the commodity sales agreement.

- Decide what procedures will be followed in carrying out sales transactions.

- On occasion, negotiate sales with buyers. Members of the committee who have extensive knowledge of the local marketplace and/or experience with monetization may be asked to manage a sale.

- Monitor and oversee the lead agent's actions.

- Appoint subcommittees as it deems necessary.

6-5 Umbrella Monetization Agreement

The MFM requires that all Title II CSs who intend to monetize jointly within a given country produce and execute an umbrella (or joint) monetization agreement. The provisions of the MFM require that the agreement detail the terms and conditions of the umbrella monetization and that a copy be submitted to FFP, where possible, with each participating CS's DAP but otherwise prior to the first call forward.

A sample umbrella monetization agreement is included with this manual as Appendix M. An umbrella monetization agreement should include, at a minimum, the following:

- the name of the CS that has been designated to act as the lead agent
- the responsibilities of the umbrella monetization committee
- the duties of the lead agent
- the obligations of the USAID mission, where applicable[73]
- the method of compensating the lead agent for its services, including whether compensation will be made as a flat fee or as a percentage of proceeds
- the roles and responsibilities of the CSs that are parties to the agreement
- a signature page with a signature line for each CS and the title of the person executing on its behalf. The committee may wish to require CS country directors execute the agreement.

Some umbrella monetization committees elect to include explicit details of forthcoming monetizations in their umbrella monetization agreements, e.g., type(s) of commodity to be monetized, tonnage levels approved for each CS, timing of sales, etc. The advantages of this type of agreement are that all of the relevant information must be provided before the document is executed and, once executed, the agreement becomes the definitive reference source for all the details of pending monetizations. The disadvantage, however, is that the agreement is inflexible and must be revised or amended if the slightest change is made to any committee member's monetization plan.

6-6 Lead (Sales) Agent

When two or more CSs monetize jointly under an umbrella monetization, an organization will be selected to act as the lead agent.

6-6.1 Roles and Responsibilities of the Lead Agent

The MFM states that the lead agent's role is limited primarily to preparing for and conducting the sale of commodities: "the Agent's responsibility terminates when the proceeds of the sale have been deposited into the individual CSs' bank accounts."[74]

More specifically, the lead agent may be required to:

- oversee the sales of commodities. This may involve hiring a consultant to conduct the actual sales. If so, the umbrella monetization committee would participate in drafting the scope of work and possibly in the hiring of the candidate

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[73] In some, but not all, cases the USAID Mission is a party to the umbrella monetization agreement.

[74] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section IX.A. in the Implementation Guidelines.

- arrange customs and port clearance prior to arrival of the commodities

- deposit sales proceeds into a separate interest-bearing bank account

- recommend specifications and packaging for the commodities being monetized

- suggest a schedule for calling forward commodities

- draft and submit, on behalf of the CS members of the umbrella monetization committee, waiver requests to the FFP/D when commodity sales are not expected to meet the cost recovery benchmark

- sign sales agreements with commodity purchasers

- disburse sales proceeds and interest earned, or distribute losses, proportionally among participants in the umbrella monetization consortium

- allow access to all records and accounts for audit purposes

- prepare financial and other reports as deemed necessary by the committee

6-6.2 Payment for Services Rendered by the Lead Agent

In some cases (e.g., in Mozambique) FFP provides 202(e) funds to cover the costs the lead agent incurs in monetizing on behalf of a consortium of CSs. In other instances, the lead agent must estimate the incremental costs it expects to incur by monetizing the commodities of other CSs. Based on this estimate, the lead agent will be paid some percentage of the foreign currency proceeds that are generated through the sale of commodities. The percentage will be included in the umbrella monetization agreement.

6-7 Obligations of the Cooperating Sponsors

In addition to its duties as an active participant on the umbrella monetization committee, each CS must perform the responsibilities below. These may also be spelled out in the umbrella monetization agreement.

- provide the lead agent with approved tonnage levels

- coordinate with USAID and the lead agent on the shipment of commodities

- endorse bills of lading and other shipping documents in a timely fashion to facilitate the transfer of commodities to the lead agent or directly to the buyer(s)

- submit financial and commodity reports as deemed necessary by the umbrella monetization committee and especially as required by USG law, regulation, and/or policy

- sign waiver requests that have been prepared by the lead agent for commodity sales that are unlikely to meet the cost recovery benchmark

Chapter Seven

COMMODITY SALES – GENERAL PRINCIPLES

After reading Chapter 7 and/or receiving training in the chapter material, one should be able to:

- *clearly state the cost recovery benchmark as defined by USAID*
- *explain the purpose of a waiver request*
- *list at least three factors to be considered when deciding whether to sell Title II commodities to a potential buyer*
- *define the term "commodity specifications"*
- *explain the term "collusion" and be able to list three steps a PVO can take to avoid collusion*

The purpose of this chapter is to outline key factors to be borne in mind when monetizing Title II commodities.

7-1 Food for Peace Policy

The MFM discusses open and competitive sales in Section VI. of the Policy Framework. FFP strongly favors competitive sales of Title II commodities to small-scale buyers over negotiated sales to parastatals and oligopolies.

CSs are advised that FFP so strongly supports open and competitive sales that it requires CSs to submit a justification as part of their DAP/PAA submissions for those programs where Title II commodities will be sold on a non-competitive basis.[75]

7-2 Cost Recovery

The cost recovery benchmark that CSs are required to meet in their monetization of Title II commodities is defined in the MFM as 80 percent of the C&F value, as quoted by FFP at the time of the call forward, plus port clearing and handling costs and duties, estimated transport costs to move the commodity to the point of sale, and expenses associated with marketing the commodity, or 100 percent of FAS, whichever is greater.

Cost Recovery Benchmark
For Title II Monetizations

Eighty percent of the C&F value, plus port clearing and handling costs and duties; estimated transport costs to the point of sale; and expenses associated with marketing the commodity; or 100% of FAS, whichever is greater.

Section VII of the MFM's Policy Framework discusses the impetus for imposing the cost recovery benchmark. One reason was that Congress and other government officials

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[75] *Monetization Field Manual: P.L. 480 Title II Programs,* Office of Food for Peace (USAID), October 16, 1998, Section VI. of the Policy Framework.

questioned why revenues being generated from Title II food aid sales amounted to less than the USG's cost of providing the food aid. A benchmark, they argued, would help to ensure that the amount of U.S. tax dollars allocated to enhancing world food security would, as closely as possible, translate into a commensurate amount of foreign currency resources. A second reason for establishing the benchmark requirement was that below-market sales of commodities were resulting in windfall profits for a few individual traders at the expense of programming funds for activities targeted toward the food insecure. Finally, Title II commodities sold at below-market prices had the potential to depress commodity prices in the local market and thus harm local producers. If local producers cannot compete in the marketplace because prices are artificially low, they may elect to cut back or cease production of certain crops. The incomes of those persons whom the CS is trying to help may very well plummet.

FFP requires that CSs meet or exceed the cost recovery benchmark in their sales of Title II commodities. Exceptions are made to this requirement only if a CS is monetizing commodities in order to induce a market-driven increase in food security. (See the third paragraph under "Justification for Monetization" in section 3-2.1.1 of this manual.)

7-2.1 Calculating Cost Recovery

In the initial stages of proposal development, the CS has calculated a preliminary cost recovery estimate as part of its monetization sales budget (refer to Section 3-2.1.1 of this manual). The purpose of this estimate was to show that sales of Title II commodities could be expected to meet FFP's cost recovery benchmark.

In the interim period between the drafting of the proposal and the point at which the CS is ready to submit a call forward, foreign exchange and/or commodity market conditions might have changed so much that the CS's ability to achieve cost recovery objectives is affected. As a result the MFM requires that, at the time of the call forward, the CS provide "updated market information and confirmation that the sales price is expected to be at or above the required benchmark."[76] In other words, the CS must recalculate its cost recovery estimate at the time the commodities are called forward. This time, however, the "price indication" that was used in calculating the preliminary cost estimate will be replaced by a "price quote." According to the MFM, the CS is to obtain price quotes from BHR/FFP/POD before the submission of the call forward.[77] Requests for price quotes must be submitted in writing and include the commodity specifications and delivery time frame. FFP will provide price quotes, in writing, within three working days following receipt of the CS's request. The price quote that FFP provides will be the FAS

[76] *Ibid.*, Section V. of the Implementation Guidelines.
[77] In some cases, the CS may request a price quote from BHR/FFP/POD so that it can negotiate a sale prior to calling forward commodities. In these cases, the CS should not request a price quote at the time of the call forward. Cost recovery is calculated using the price quote that BHR/FFP/POD provided at the time the sale was negotiated.

price of the commodity; in other words it will include all costs associated with procuring the commodity and transporting it to the U.S. port.[78]

The updated cost recovery estimate is calculated in exactly the same way as the preliminary cost recovery estimate (the latter described extensively in section 3-2.1.1 of this manual) except that, as mentioned immediately above, the CS will replace the price indication with a price quote. The revised estimate should be provided to the Mission, in presence countries, with its request for concurrence on a call forward. (See Chapter 13 for more information about calls forward.)

7-2.2 Waivers

In all cases, when a CS does not expect to meet FFP's cost recovery benchmark on the sale of commodities it is calling forward, it must submit a written waiver request to the FFP/D. A CS who, in accordance with its DAP, is monetizing in order to develop local markets (see paragraph 4 under Justification for Monetization in Chapter 3 Section 3-2.1.1 of this manual) should reiterate its purpose for monetizing and quote the section of the approved DAP where this is discussed. A CS who had intended to achieve an acceptable cost recovery rate but, for whatever reason, is unable to do so, must provide a detailed explanation in the waiver request about why it is unable to meet the benchmark. Prior to submitting a waiver request, the CS should try to obtain the support of the local USAID Mission and should consult the FFP Officer in Washington.

With regard to waiver requests in an umbrella monetization situation, usually the lead agent drafts such requests on behalf of all the CSs who are members of the umbrella monetization committee.

FFP has 15 days to respond, in writing, to the CS's waiver request.

7-2.3 Reporting Actual Cost Recovery Results

Within 30 days following the completion of a sale, the CS must report to the USAID Mission (or directly to FFP in non-presence countries), the actual sales price in comparison to the cost recovery benchmark.[79] The report must provide "the actual price at which the commodity was sold; total sales revenue [in U.S. dollars]; and the quantity sold, [in metric tons]."[80] A standard form for reporting this information is provided in the MFM as Appendix C. The MFM further states that "in the event the CS fails to achieve cost recovery, the Mission shall report back to FFP/D the circumstances regarding the loss."[81]

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[78] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section I.A.2. of the Implementation Guidelines.
[79] *Ibid.*, Section VII.A. of the Implementation Guidelines.
[80] *Ibid.*, Section VIII.E. of the Implementation Guidelines.
[81] *Ibid.*, Section VII.A. of the Implementation Guidelines.

A CS might conceivably fail to meet the cost recovery benchmark, despite diligent efforts to comply, simply because the foreign currency depreciates vis-à-vis the U.S. dollar between the time the cost recovery estimate is calculated and the time the foreign currency proceeds are remitted. This concept is discussed in the following section.

7-2.4 Exchange Rate Considerations

Because CSs report preliminary and updated cost recovery estimates as well as final cost recovery results in U.S. dollars but conduct sales in foreign currency, they are subject to foreign exchange risk. The following example illustrates the consequences of assuming foreign exchange risk. A CS monetizing in West Africa submits a cost recovery estimate with its call forward that meets FFP's cost recovery requirements. The call forward is approved, and the CS sells one metric ton of flour for CFA 300,000 which, at the time of the call forward, equals U.S. $600. Between the time the sale is consummated and the time the buyer pays for the commodities, the CFA is devalued, so that when the CS collects from the buyer, the CS gets the agreed upon amount of CFA 300,000, but this amount now converts to only U.S. $550. If the CS sales price of $600 exactly met the cost recovery benchmark at the time of the call forward, then the U.S. dollar yield following the CFA devaluation will fail to meet the cost recovery benchmark. By ensuring that the sales contract is denominated in U.S. dollars and includes a methodology for fixing the exchange rate, the CS can minimize the risk in the transaction.

Catholic Relief Services's case study concerning the monetization of refined vegetable oil in the Gambia, which is included at the end of this chapter, illustrates the important role that currency fluctuations can play in meeting cost recovery requirements.

7-3 Advantages to Buyers of Monetized Commodities

In many cases, the single most daunting challenge that a CS faces when marketing Title II commodities is obtaining a fair price from local buyers. By enumerating the advantages of purchasing Title II commodities, a CS may be able to persuade a potential buyer to increase his/her offer to an acceptable level. Four important advantages of monetized commodities are summarized below.

- In most cases, Title II commodities can be paid for with the buyer's own currency. Precious hard currency, which the buyer may not have ready access to, can be reserved for other transactions.

- The CS has some flexibility with regard to the financing terms it can offer. Although the commodities must be paid for in full[82] before they are transferred to the purchaser,

[82] In no case should title to or possession of commodities pass to the buyer until payment in full has been received by the CS. "Payment in full" is defined as: 100 percent payment in cash; or payment that is covered by a bank guarantee or irrevocable letter of credit; or payment that is covered by another financial instrument/arrangement which has been cleared in advance by FFP. CSs should be advised that the transfer of commodities to a buyer on the presumed security of a financial instrument other than cash

the CS can work with the buyer to design an accommodating payment plan that includes the necessary payment guarantee instruments. (Section 11-2.3 discusses the concept of "collateral management," which is a payment mechanism that affords the buyer some flexibility with respect to payment for commodities.)

- Proceeds from the sale of commodities are being used to support programs designed to increase the household income of the poor. Increased incomes will likely lead to greater demand for the buyer's goods.

- The buyer will receive commodities having the specifications s/he requires, as long as the specifications were made known to the CS and reflected in the call forward. Potential buyers should be reassured that the characteristics and quality of Title II commodities are on par with those of commercially purchased commodities. (See Section 7-6 below.)

7-4 Commodity Futures Markets

Many buyers nowadays have access to the Internet and hence are able to track a wide range of commodity information, including futures market prices. In meetings with PVO representatives, buyers may try to bargain down the price of Title II commodities by presenting a printout of futures market prices. PVO representatives should not be intimidated by this but rather be aware that virtually no one procures commodities through the futures market; it is a mechanism not for buying and selling commodities but rather for hedging (i.e., protecting against commodity price swings). The PVO representative should explain to the buyer that the futures price does not represent the price at which s/he could purchase commodities. Furthermore, the costs associated with dealing in the futures market are high. The buyer would be required to open a trading account with a broker and deposit a relatively large sum of cash in order to cover broker fees, transaction costs, and "margin[83]." (A brief overview of futures trading is included as Appendix N.)

7-5 Buyer Qualification

A CS wants to avoid at all costs having a buyer renege on his/her agreement to purchase commodities. Buyer default can be prevented if potential buyers are screened, or pre-qualified, prior to consummating a sale. The CS may elect to sell commodities only to those buyers who:

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renders the CS fully responsible for the cash value of the commodities in the event that the financial instrument cannot be activated. The CS is therefore strongly encouraged to carry out due diligence on the soundness of the guaranteeing institution before accepting any financial instrument against the release of commodities.

[83] Margin is a deposit of earnest money, similar to a performance bond, required in futures transactions. The deposit represents an investor's intent to stand good for any financial obligations his/her futures position incurs.

- are incorporated
- are registered with the local tax authorities and are current with their tax payments
- maintain an account with a licensed commercial bank
- hold a special trading license or permit
- have no outstanding debts to the CS

A CS can take three measures to protect itself against a buyer's backing out of a monetization transaction.

- For negotiated sales, the CS can ensure that a fully executed sales agreement is in place prior to submitting a call forward or as soon thereafter as possible but definitely prior to the lifting of commodities at the U.S. port. (Note, however, that contracts made too far in advance are a primary cause of buyers paying lower prices than they otherwise would, since the degree of risk that the buyer must assume is increased. The greater the variance from normal commercial practices, the greater the price discount that can be anticipated.)

- The CS should secure a deposit from the buyer. The MFM specifically states, "The CS should obtain a performance bond prior to submitting a call forward to BHR/FFP/POD. The performance bond should equal at least 10 percent of the expected sales price and be denominated in the currency in which the sale will take place. The bond should take the form of an irrevocable letter of credit (or similar instrument, in accordance with local practices) and guarantee payment to the CS of the amount of the bond in the event the buyer of the Title II commodities fails to perform in accordance with the sales agreement."[84] (Sales agreements and various types of payment instruments are discussed in Chapter 11.)

- In cases in which large sales will be conducted through the tendering of bids, the CS should require that each bid be accompanied by a deposit of at least 10 percent of the value of the commodities being bid for. Deposits from unsuccessful bidders should be promptly returned, while deposits from successful bidders should be retained and applied to the final payment.

The second case study included with this chapter demonstrates the lessons that the Kenya Food Security Consortium learned about securing commodity sales prior to calling forward commodities.

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[84] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section VI.B. of the Implementation Guidelines.

7-6 Commodity Specifications

The term "commodity specifications" refers to the characteristics of a particular Title II commodity being programmed by a CS. For example, corn can be either yellow or white; wheat can be hard or soft; rice is long- medium- or short-grain; etc. A CS who intends to monetize Title II commodities should interview local buyers, refiners, processors, bakers, consumers, etc., to learn which characteristics are preferred by the local people. The CS should be especially aware of factors that could change the perceived quality of the commodity. In unprocessed commodities, these factors might include moisture content, percentage of broken and fine material, percentage of foreign material, etc. With a clear understanding of users' preferences, the CS can contact FFP to ascertain whether commodities having the preferred characteristics are available. The CS should then spell out these characteristics in detail in the call forward submitted to FFP.

Responding to the preferences of the local people is one way CSs can help to foster successful monetization transactions.

7-7 Commodity Packaging

Those who market Title II commodities on behalf of a CS should be familiar with the different types of packaging that are available for the commodity being monetized. Local buyers may have a strong preference for one type of packaging over another.

Note: The term "Not to be sold or exchanged" should ***not*** *appear on the packaging of commodities that are being monetized.*

7-8 Commodity Samples

Providing samples of Title II commodities for inspection by potential buyers is another step that CSs can take to foster successful monetization transactions. Regrettably, samples are not readily available from the U.S. government. Appendix 4.2 lists a number of producer and processor groups who provide commodities for the Title II program. CSs can contact these organizations to request samples. Africare has obtained samples of wheat flour from Archer Daniels Midland and peas/lentils from the USA Dry Pea & Lentil Council. U.S. Wheat Associates has also been helpful in providing samples. When requesting samples from suppliers, the CS should spell out in detail the exact specifications of the desired commodity sample.

CSs should provide samples only if they can be assured that the characteristics of the commodity that will be delivered are exactly the same as the characteristics of the samples. By taking this precaution, CSs can avoid failed sales transactions.

7-9 Collusion[85]

All buyers of Title II commodities have an inherent interest in purchasing commodities at the lowest possible price. In some markets buyers will resort to the unfair trade practice known as collusion. Collusion, in the context of a Title II sale, occurs when two or more buyers consort in an effort to force down the price of the commodities the CS is selling. The CS should suspect collusion if:

- The prospective buyers offer identical, or almost identical, prices and sales terms.

- For some inexplicable reason, each potential buyer indicates interest in a different delivery date, e.g., one buyer is interested only in a January delivery, another buyer only wants to take delivery in April, a third buyer is only willing to accept delivery in July, etc.

A CS can take three steps to discourage buyers from colluding.

- Whenever possible, the CS should design a sales system that encourages widespread participation. The more buyers, the greater the competition and the more difficulty the buyers will have in colluding to fix prices. Selling commodities in small lots is one way to broaden buyer participation, although this is not always practicable.

- The sales system should be designed to allow the CS to cancel the sale if collusion is suspected. A cancellation clause, empowering the CS to cancel the sale if an irregularity is detected, should be written into every sales agreement. When there is strong evidence of collusion, outright cancellation of the sale is recommended.

- The CS can also prevent collusion by safeguarding important information that would be useful to buyers. Buyers have been known to approach CS staff members to obtain information about calls forward, stocks on hand, cost recovery benchmarks, commodity values, ongoing negotiations, and so forth. By minimizing the number of people who are privy to this type of information, the CS can reduce the chances that its sales will be spoiled by collusion.

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[85] *Save the Children Monetization Implementation Manual: a How-to Manual on Implementing Monetization Projects in the Field*, Marine Overseas Services, Inc., February 1993, Section 3.7.

Case Study (Lesson Learned"): Cost Recovery and the Monetization of Refined Vegetable Oil in The Gambia

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I. Introduction and Problem Statement

For the past several years, Catholic Relief Services (CRS) has successfully monetized refined vegetable oil in The Gambia in order to generate proceeds for its two main programs: a Food-Assisted Child Survival (FACS) Project and a Sesame Growers' Association Project. Both of these projects were approved in CRS/The Gambia's FY 1998-2000 Development Activity Proposal (DAP), along with its request for the monetization of approximately 4,296 MT of refined vegetable oil.

In 1998, CRS/The Gambia once again sought to monetize approximately 1,490 MT of refined vegetable oil to fund its projects for FY1999. In September 1998, CRS submitted a tender call for the sale of 208 one-liter drums of vegetable oil, publicizing the sale in the local press and accepting sealed bids from potential buyers. In previous years, cost recovery for vegetable oil had not been a concern, as domestic prices had been sufficient to meet USAID/Food For Peace's cost recovery benchmark of "80% of the C&F value...or 100 % of FAS, whichever is greater."[87] In 1998, however, only two bids were submitted for CRS' vegetable oil, and both were substantially below the cost recovery benchmark. Although CRS/The Gambia contemplated requesting a waiver from Food for Peace (FFP) in Washington, past experience suggested that waivers had been difficult to obtain. For this reason, CRS decided to conduct an updated market analysis in the Gambia, with two main objectives: 1) to determine the reasons for CRS/The Gambia's difficulty in meeting cost recovery; and 2) to devise solutions that would allow CRS/The Gambia to continue its monetization program.

II. Identifying the Problem

Faced with the above situation, CRS carried out a market analysis to determine the reasons for the low bids for its vegetable oil. To this end, CRS/The Gambia first looked at the vegetable oil market to determine whether local supply and demand had depressed domestic prices below the cost recovery benchmark. After concluding that domestic and import parity prices were well above cost recovery, CRS conducted further research to ascertain if there were additional macroeconomic factors that could explain the low bid

[86] The opinions expressed in this case study are solely those of the author, and do not necessarily represent the views of Catholic Relief Services.
[87] USAID, Office of Food for Peace. *Monetization Field Manual: P.L. 480 Title II Programs.* Washington, D.C.: October 1998, p. 8.

prices. The survey revealed that two main factors had strongly influenced the bid prices: 1) the depreciation of the local currency (the *Dalasi*) against the dollar; and 2) the structure of the domestic buyers' market for vegetable oil.

In the months preceding the tender process, the Gambian currency, the *Dalasi*, had depreciated by 2.8 percent against the dollar, from 10.65D/$ to 10.95D/$. Although this rate of depreciation was minimal, CRS/The Gambia quickly learned that even small fluctuations in the exchange rate could make a big difference for the purposes of cost recovery.[88] From discussions with a variety of officials in The Gambia, CRS learned that the currency depreciation was a normal trend, and that these fluctuations coincided with the supply of foreign exchange earnings in the domestic market. For this reason, the Gambian currency often appreciated during the tourist season and after the groundnut harvest, the two main sources of foreign exchange.

The second factor affecting CRS/The Gambia's monetization program was the structure of the buyers' market. As part of its updated market analysis, CRS analyzed the market structure for vegetable oil in order to calculate marketing margins, as well as determine whether these margins could explain the low bid prices. During the course of the study, CRS/The Gambia learned that the buyers' market for vegetable oil was dominated by a few large buyers, functioning essentially as an oligopoly. Although a number of traders were involved in the vegetable oil market, the buyers' market for CRS' vegetable oil had become increasingly thin, as an unofficial cartel had been successful in outbidding smaller competitors. Consequently, by September 1998, the competition for CRS' vegetable oil was thin, and the tender process essentially allowed the larger buyers to submit bids without fear of competition. This resulted in bids well below the fair market price, as well as below the cost recovery benchmark.

III. Lessons Learned: CRS/The Gambia's Solutions

With the above findings, CRS/The Gambia concluded that the cost recovery problem was due to overarching market conditions rather than specific problems within the domestic vegetable oil market. Nevertheless, CRS/The Gambia identified several aspects of its monetization program that made it vulnerable to such market fluctuations and contributed to its cost recovery problems: 1) the timing of the tender sales, which coincided with the depreciation of the Gambian currency; 2) the denomination of the sales contracts in local currency terms, which made the sales price susceptible to exchange rate fluctuations; and 3) the type of sales method used (tender sales), which was more appropriate for a more competitive marketing environment. In order to avoid similar problems in the future, CRS/The Gambia began changing certain aspects of its monetization program. CRS/The Gambia is now more cognizant of normal currency fluctuations and will try to conduct its

[88] For example, using the October 1998 exchange rate of 10.95 D/$, the bid offer was approximately $98/MT below the cost recovery benchmark; at the April 1998 exchange rate of 10.65D/$, the bid offer was $75/MT below the cost recovery benchmark.

sales during certain times of year.[89] CRS/The Gambia has also considered the possibility of denominating its sales contracts in dollar terms in order to avoid problems with exchange rate conversions. Most importantly, however, CRS/The Gambia has begun revising its sales process. While CRS has had much success with tender sales in the past, tender sales often work best in a highly competitive market. Given the current market structure in The Gambia, CRS/The Gambia has decided to use direct sales negotiations rather than the tender process, so that it can engage in sales negotiations with smaller buyers. In this manner, CRS hopes that the smaller traders will be able to participate in the sales process, and that the increased competition for smaller lots will raise the sales price.

At the time of writing, CRS/The Gambia is still implementing these changes, and will not complete the proposed monetization sale until early 1999. Nevertheless, CRS/The Gambia's problems with cost recovery forced it to rethink its traditional monetization program, and to implement reforms that would allow it to better cope with future market fluctuations.

[89] Despite CRS/The Gambia's plans to conduct its monetization sales at certain times of year, this is not always feasible given the need for funds and delays in shipping.

Case Study: FHI/Kenya--Securing Commodity Sales

FHI/Kenya is part of a monetization consortium referred to as the Kenya Food Security Consortium (KFSC). This consortium is comprised of the PVOs in Kenya that are implementing Title II programs and the Title II Program Officer from the local USAID Mission.

A lead PVO takes responsibility for the entire monetization process, including: logistics, shipping, sale of commodity, and liaison with USAID and the GOK.

The KFSC negotiated and signed a sales agreement with Elianto (K) Ltd., a local manufacturing company, for the sale of 5,000 MT of soybeans at a price of U.S.$280/MT. After submitting the call forward to FFP Washington, the consortium learned that Elianto had been declared bankrupt and was unable to honor the sales agreement. FFP was able to cancel the call forward before the commodity had been purchased.

Moreover, the bankrupt buyer was unable to pay the consortium the 2 percent penalty (approximately Kshs. 1,500,000) that it owed for breach of contract. FHI/K learned a number of valuable lessons from this experience.

- The financial status of a buyer should be thoroughly investigated before a sales agreement is signed.

- At the time a sales agreement is signed, the seller should secure a deposit, and an irrevocable letter of credit should be in place.

- Commodities should not be called forward until all financial arrangements have been made.

In order to avert a prolonged and expensive legal battle as well as potential negative publicity, the KFSC settled with Elianto for the sum of Kshs.500,000 as compensation for its breach of contract.

Chapter Eight

OPEN AND COMPETITIVE COMMODITY SALES – TENDER SALES[90,91]

After reading Chapter 8 and/or receiving training in the chapter material, one should be able to:

- *describe what a tender sale is*
- *list at least three advantages of tender sales*
- *explain why the timing of a tender sale is important*
- *explain what is meant by transparency and why it is important*
- *discuss the steps for managing a tender sale*

8-1 Tender Sales - Process

Open and competitive sales may be conducted in the form of tender sales. To carry out a sale by tender, the CS, or its agent, first publicly offers the commodity in fixed quantities or “lots.” Potential buyers submit written bids stating the number of lots they wish to buy and the price per lot they are prepared to pay. Bids are submitted in sealed envelopes by a pre-determined fixed date and time. Ideally, the bids are opened publicly at the appointed time and place, read aloud, and recorded. After bids not conforming with published procedures are eliminated, the remaining bids are sorted by value from the highest to the lowest. The highest bidders are then selected, and purchases are awarded. (See Appendix O for a sample “sale-by-tender” information packet.)

8-2 Advantages of Sale by Tender

Sale by tender is a very effective way to conduct commodity monetization for the following reasons.

- The sales price is established through competition in situations where the CS may not readily be able to establish a fair market value.

- A well-conducted tender mitigates against questions of impropriety and builds confidence among buyers because of its transparency.

- Tender sales, vis-à-vis sales by negotiation or open outcry auction, often result in higher sales prices and increased amounts of sales proceeds.

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[90] Much of the material presented in this chapter has been reproduced with the permission of Save the Children. The material was first published in the *Save the Children Monetization Implementation Manual: a How-to Manual on Implementing Monetization Projects in the Field*, authored by Marine Overseas Services, Inc., and dated February 1993.
[91] The author gratefully acknowledges the detailed feedback regarding the material in this chapter that was provided by Paola Lang of Nathan Associates.

- Commodity prices tend to be volatile, and the tender sales process allows bidders to respond to changes in commodity prices.

- Tender sales offer the CS an opportunity to educate buyers about competitive market practices.

- CS staff can conduct sales by public tender themselves, thus avoiding the payment of fees to auctioneers or sales agents.

- Sale by public tender works well in countries where different languages are spoken.

- Deposit and bond procedures can be conducted in a more orderly way with sales by public tender than with open outcry auctions.

8-3 Disadvantages of Sale by Tender

Some of the drawbacks associated with tender sales are:

- Management and administrative costs can be somewhat higher than with other sales procedures.

- Local businesspeople often lack experience in purchasing by public tender.

- Public tenders do not work well in a market dominated by one or a few buyers.

- Tenders do not work well in a market where commodity prices are heavily regulated.

8-4 Timing of the Tender Sale

The timing of tender sales is critical. CSs should bear in mind the following precautions to ensure successful sales:

- CSs should avoid carrying out tender sales when the market is already well provisioned with the commodity to be monetized, either from local harvests or scheduled imports from other sources.

- Wherever possible, sales should be scheduled as part of an ongoing series of tender calls for limited amounts of commodity.

- Large sales should be announced as far in advance as possible, ideally three months or more ahead of time, so that traders and importers can adjust their commodity importation and acquisition plans. Although the announcement should be made well in advance of the actual sale, bids should be accepted over a much shorter time frame, e.g., a week or less. For smaller sales, the announcement can be made up to a week in advance of the sale.

8-5 Transparency

Some local businesspeople may be unfamiliar with tender sales and suspicious of them. This may be true, in particular, for the owners of small and medium-sized businesses. Larger businesses may be more familiar with tender sales because they are sometimes used by host governments. Even they, however, may regard the practice as corrupt and unfair if they have previously had a bad experience with this type of sale.

Accordingly, the CS must plan carefully all aspects of the tender process: the call for bids, receipt of bids, opening of bids, and selection of buyers. The CS should publicize the terms of the sale in advance and adhere to them rigidly. Once a call for bids has been issued and the sales process launched, the CS should not make changes in that process unless specifically provided for in the tender announcement. Doing so could result in competing bidders responding under different rules, thus destroying the fairness of the exercise. It is very difficult, if not impossible, to evaluate bids fairly given differing criteria. The CS also risks losing credibility and/or being challenged by potential buyers who may suspect that changes will disadvantage them.

Transparency: The Strong Point of Tender Sales

When conducting a sale by tender, the CS should carry out every step of the process in public. Although this may be frustrating and less than efficient, transparency will bring substantial benefits:

- fewer disgruntled bidders who charge corrupt sales practices
- greater confidence and trust in the CS on the part of the local business community
- encouragement of new participants in the tender process, thus increasing competition and generating more sales proceeds

Changes in the terms, conditions, or procedures of a tender process should be made only between tender calls. No change should ever be made between the announcement of the tender call and the announcement of the winning bidders. If an error or oversight in the process is discovered, or if some unforeseen circumstances arise, the sale should be canceled.

8-6 Lot Size

Commodities should be offered for sale in lots (quantities) of a fixed size. A lot may be as large as an entire consignment or as small as the basic unit of commodity packaging. A uniform lot size makes managing a sale much easier because it provides a standard against which to evaluate bids. As a general rule, sales should be made in whole lots only.

Lot size should be set based on the objectives of the CS that is selling the commodities. If the CS is attempting to increase competition and open markets to small buyers, then small lot sales would be appropriate. In general, the smaller the lot size offered, the greater the number of bids that will be submitted, and the larger the number of successful bidders and individual sales that will be transacted. Smaller lot sizes usually result in an incremental increase in administrative costs. This increase in costs is generally recovered, however, because small lot sales tend to generate a greater amount of revenue than larger lot sales.

If the CS is primarily concerned with generating the cash needed to fund its food security programs, then the lot size could be set substantially higher.

8-7 Maximum and Minimum Purchases

Usually the minimum purchase determines or equals the lot size. In some circumstances, however, the CS may have to establish a lot size smaller than the minimum purchase. This can ease delivery by spreading deliveries over a longer period of time, and is useful when the sale involves large quantities of the commodity going to a single buyer.

The CS may wish to limit the total amount of commodity to be sold, thereby:

- imposing some order on market prices by releasing fixed amounts of commodity into the market at regular intervals.

- maintaining a certain cash-flow position and avoiding holding large sums of currency, which can result in losses due to inflation and currency devaluation.

The CS may also elect to limit the total amount of commodity that can be sold to one buyer in the first round of bids. After all buyers with acceptable bids have had an opportunity to purchase, the CS can sell additional commodities to buyers wishing to purchase more. By limiting purchases in this way, the CS:

- prevents a single buyer from gaining control of the market.

- promotes the development of small private traders and the small-scale private sector.

At whatever level the maximum sale is fixed, the terms of the sale should stipulate the total amount of the commodity being offered for sale, expressed in number of lots, while reserving the CS's right to sell less than that total amount.

Sales should never exceed the amount publicized as being offered. Buyers calculate their tenders, at least in part, based on the total amount of the commodity they anticipate will enter the market. By selling more than the published maximum, a CS undermines the buyers' faith and places them at financial risk. This could discourage their participation in future sales.

Limiting the amount of a commodity that can be purchased by a single buyer sometimes proves ineffective because large buyers respond by simply submitting tenders under other names. A CS's familiarity with the local business community may help to mitigate against this.

8-8 Managing the Tender Sale

The CS must formally establish and announce the time frame within which bids will be received. Bids can generally be received beginning any time from the initial publication of the bid solicitation up to but no later than a clearly announced cut-off date and time, including the hour. The CS should announce in the tender solicitation the date, time, and location of the bid-opening session . The established date and time of the bid-opening session should be timed to fall within normal business hours. The location should be accessible and large enough to accommodate all bidders and interested members of the public who wish to attend.

For small commodity sales, the CS should generally allow up to a week for buyers to submit bids. For larger sales, the CS might decide to publish the call for bids three months or more in advance of the sale. Buyers of large quantities need time to meet the requirements of the call for bids and to raise financing. Potential bidders may be out of the country or "up-country," away from the town in which the call was issued.

During the bid-opening session, the CS should ensure that:

- Bids are submitted in a standardized format.
- Bids are submitted in sealed envelopes.
- Each envelope contains only one bid.
- Each bid is recorded as soon as it is received through assignment of an identification number that includes both the bid and tender numbers. These numbers should be entered in a logbook and recorded on the sealed envelope containing the bid.
- Each bidder is issued a receipt bearing the assigned bid number
- The sealed envelope(s) is/are locked in a strongbox in the presence of the bidder. The bidder should understand that the box will remain locked until the day of the bid-opening session, when it will be opened publicly and all envelopes unsealed.

The CS should reject out of hand any bids that are submitted late. To ensure transparency, the CS should post publicly, immediately after the bid closing, the number of bids received. This will assure on-time bidders that late bids were not accepted. Bidders will later be able to confirm this number by noting the number of bids opened at the official bid-opening session.

8-9 Selection of Buyers

To achieve both transparency and a high level of competition, the CS should use the following procedures to select buyers:

- Invite representatives of the host country government, counterpart agencies, USAID and the U.S. Embassy to attend the bid-opening event. One or more of these representatives can be asked to act as an "official observer" and attest to the integrity of the tender process.

- Open the seals and/or locks on the tender box in full view of the assembly.

- Remove the tenders and sort them in order by the number assigned to them at the time of submission.

- Open the tenders and read them aloud.

- Carefully examine each tender and verify it for completeness, arithmetical correctness, and compliance with all criteria set out in the bid solicitation. Immediately and publicly reject any tender found not to meet one or more of the established criteria.

- Where feasible, enter data from all accepted tenders in a database for storage and ease of handling. Verify all data entries.

- Keep a record of the basic data contained in each bid, including whether the bid was accepted or rejected.

- Sort the bids according to value following verification of all data entries.

- Identify winning bidders by moving downward from the highest offered price until an established cut-off price is reached or until all available commodity is sold.

One of two procedures can be used to fix the sales price. The method for fixing the sales price, along with an explanation of the method, must be included in the tender sale information packet.

- <u>Pay-as-Bid</u>: Each bidder who is selected pays the price s/he bid. This procedure tends to increase total income. However, the CS must take care when selecting the cut-off price (which is done in private after all the bids have been opened and called out) to limit the price spread between the highest and lowest bids accepted. When marketing the commodity, higher bidders could suffer serious losses if underpriced by lower bidders. In other cases, the highest bidders may choose to default because they would be unable to compete with buyers purchasing at lower bids.

- <u>Stop-Out Price (Uniform Pricing Method)</u>: The CS calculates a single price by moving down the list of eligible bids, which have been ranked by price, either to the floor price or until an offer is reached where the total of the offers at and above that price equals or just exceeds the total quantity of the commodity for sale. All bidders are then asked to pay that stop-out or uniform price. This system has the advantage of allowing buyers to compete, in resale, on a level playing field, limiting the possibility of financial loss to them and alleviating the problem of bid defaults. Uniform pricing tends, however, to lower the amount of sales proceeds.

The Pay-as-Bid system, which requires careful management, is the preferred method of buyer selection in most circumstances. *Note that whichever method is used, the CS must comply with cost recovery requirements.*

The CS should publicly announce winners soon after the bid-opening exercise. The sooner this is done, the less gossip there will be about bid manipulation. The CS should post at its field office a list of winning bidders, along with copies of the database entries from which the selections were made. In addition, it can make announcements through the local print and broadcast media. An advertisement in the newspaper provides documentary evidence of a formal announcement, while radio and television reach winners and losers more quickly. Speed is important in terms of payment deadlines. The CS should include in the tender sale information packet information about how the winners will be announced.

8-10 Payment Procedures

Immediately upon selection and announcement of winning tenders, the CS should place the deposits of successful buyers in the monetization proceeds bank account. Except for the buyers' deposits, the CS should avoid directly handling instruments of payment. It should be an established and publicized part of the sales procedures that buyers will deposit the balance of their payment directly into the monetization proceeds bank account. Commodities should only be released upon proof of deposit.

8-11 Delivery Procedures

Delivery of the commodity should not be made until the CS has received full payment. The buyer should take delivery as soon as possible after signing the sales agreement and making payment.

The CS should require that each buyer sign a delivery receipt, covering all aspects of quantity and quality of the commodity, at the time of delivery.

8-12 Procedure Review

The CS should review all procedures that will be followed in carrying out the tender sale with the following:

- an attorney, to ensure conformity with local law

- relevant government agencies and ministries, to ensure conformity with existing guidelines or policies and to ensure host government support

- the USAID Mission

- local entrepreneurs, who will be the ultimate sales participants. This can be done by publishing a draft of the proposed procedures and inviting interested businesspeople to comment. Alternatively, the CS can arrange a seminar for local businesspeople to discuss the monetization program, in particular the tender sale procedures.

8-13 Notes on Sale by Tender

Although some local circumstances may preclude sales by tender, the tender bid system is a preferred monetization sales method. Tendering is most effective in a market comprised of a large number of identifiable potential buyers. Because it attracts a substantial number of bidders, it also works well in markets where the potential for effective competition initially appears to be limited.

In many countries, small and medium-sized businesses may never before have had the opportunity to trade in imported commodities due to the difficulty of obtaining foreign exchange. Monetization makes an imported commodity available in the purchaser's currency and therefore allows CSs to access what may be a substantial pool of capital, albeit capital held in small amounts by a large number of individuals. By offering commodities in small lots through a tender sale system, the CS may discover an untapped commodity market.

Sale by tender is not the best option in all situations. If the CS already knows of buyers who are prepared to take delivery at end of ship's tackle, then sale by tender may be less effective, causing unnecessary time delays and administrative burdens. On the other hand, it may be that the heavy financial requirements placed upon a buyer taking title to a large shipment of commodity in the port (i.e., payment for purchase of the commodity plus transport, port, and storage charges) will greatly reduce the number of qualified buyers.

If, however, there is a reasonable expectation of competition, tender sales offer the best means of maximizing proceeds.

Some additional points regarding tender sales:

- Free commodity markets tend to have only a small number of importers. These importers sell wholesale to smaller businesspeople who function as both petty wholesalers and retailers and who, in turn, sell onward to the smallest retailers.

- The tender process is designed to attract the maximum number of buyers to the market, increasing competition and, as a result, increasing prices and sales proceeds.

- Generally, the smaller the lot size, the higher the price the CS can expect to obtain.

- Tender sales will work best where the CS has sufficient storage space available, establishes a sales office, and undertakes to market the commodity aggressively in small lots through a regular and ongoing schedule of frequent tender calls.

- The CS may wish to issue a call for bids well in advance of a sale so that if response is limited or otherwise unacceptable, it will have ample time to cancel the call and negotiate the sale.

Case Study: ACDI/Uganda Tender Sales

Introduction

PVOs and Cooperating Sponsors that do not traditionally utilize food aid resources to support programs in nutrition, food for work, and emergency activities tend to approach monetization from a slightly different perspective than those who do. They invest greater efforts in the economic impact of the monetization exercise itself. This philosophy may have been best demonstrated by the Agricultural Cooperative Development International (ACDI[92]) program in Uganda.

Background

Before the era of Idi Amin Dada and the expulsion of Asian Ugandans, Uganda was a net exporter of edible oils. By 1988, however, when ACDI developed its P.L. 480 Title II monetization project "To Strengthen Oil Seed and Edible Oil Production," the country was producing edible oils that met less than 2 percent of its needs.

ACDI had never before been a P.L. 480 Title II Cooperating Sponsor, but had a longstanding relationship with the Uganda Cooperative Alliance (UCA), the apex organization of the local farm cooperative movement. In collaboration with UCA, ACDI designed a project to invest monetization proceeds in the revitalization of local edible oil production and other support to the cooperative movement.

Prior to the ACDI project, USAID had provided vegetable cooking oil under P.L. 480 Title I for marketing through a Ugandan parastatal, the Foods and Beverages Corporation. Commodity accounting suffered from serious shortcomings, and the program sustained losses of more than 20 percent of commodity shipped.

Considering the poor performance of the Foods and Beverages Corporation, and in line with its business orientation, ACDI undertook an assessment of the Ugandan commodity trade and concluded that Title II monetization could be executed through the private sector.

In analyzing the local commodity market, however, ACDI discovered that as much as 95 percent of edible oil imports to Uganda (primarily Malayan palm oil) was in the hands of three trading firms, and over half of the import/wholesale market was controlled by a single firm.

[92] Now known as ACDI/VOCA

Because the primary project objective was to revitalize domestic edible oil production, sales had to attract the highest prices possible in order to ensure sufficient price incentives to Ugandan producers. Preliminary discussions with large traders indicated that negotiated large volume sales were unlikely to yield fair market prices or to meet minimum P.L. 480 sales price requirements. The discussions also made it clear that even large volume tender auctions held a considerable risk of collusion, which would result in low bids and lead to depressed market prices. At the same time, however, ACDI realized that only the large traders had access to bank financing or other formal credit.

In response to these concerns, ACDI decided to conduct sales by tender auction but to set lot sizes (and minimum sales) at the very low level of one metric ton (five drums, 57 pails, or 47 cartons of six one-gallon tins). In this way ACDI hoped to break the monopoly of the existing importers and attract a sufficient number of small and medium-sized businesspeople (retailers and petty wholesalers) to ensure sufficient competition and thus encourage price formation that reflected the fair market value of the commodity.

ACDI conducted a series of information and marketing seminars throughout the country to promote the monetization program among small traders and learn how the program could respond to their concerns and encourage their participation.
The seminars showed that small traders, operating with very limited resources and on very narrow margins (in an economy with high inflation and a rapidly devaluing currency), would require a very quick turnover of their investment to maintain cash flow and operate profitably. Unless the commodity was on hand for immediate delivery, and unless the tender auction could be held within a very short time frame, small businesses would be unable to risk participation. The seminars also demonstrated, however, that small traders were enthusiastic about what they saw as a profitable opportunity to buy directly from ACDI as an importer rather than at prices already marked up by mid-level wholesalers.

Since the importance of maintaining stable and maximum market prices justified an increase in operating costs, ACDI concluded it should establish its own in-country warehousing operation and maintain sufficient inventory to immediately meet delivery of sales, rather than attempt sales before a call forward. A warehouse facility was rented, and the first 1,500 MT of commodity was called forward and delivered to Kampala before the first tender call was issued.

Sales System

The tender auction system that ACDI established offered bidders one-metric-ton lots of vegetable oil packed in drums, pails, or cartons of one-gallon tins. A maximum volume (usually between 250 and 500 MT) of commodity was placed on offer; the minimum purchase was one lot (one MT); and the maximum equaled the total amount on offer. Each tender call was published in four English language newspapers and one local language newspaper and broadcast by radio in English and five local languages.

Bids were submitted on a standardized bid form issued free of charge by ACDI's P.L. 480 sales office and accompanied by a deposit, in the form of a bank draft, amounting to 5 percent of the total bid value. Tender bids were submitted by a deadline (established by date and time in the tender call) falling approximately 10 days after announcement of each call for bids.

ACDI opened the bids publicly in the UCA conference room the morning after the submission deadline, reviewed them for compliance, and qualified or disqualified them. Following the official opening exercise, ACDI entered the bids entered in a database and ranked them by value. Winning bids were selected from the highest downward until the total volume of commodity on offer was exhausted or until a minimum price acceptable to ACDI was reached (approximately the CIF value recalculated using prevailing exchange rates on the day each tender call closed). The volume placed on sale in each tender call, as well as minimum acceptable prices, was also affected to some extent by anticipated program financing requirements.

ACDI posted the full computer printout, showing all bidders, winners, and losers, within 48 hours of the tender opening outside its P.L. 480 sales office. It also published a list of winning bidders for each round of sales in local newspapers and broadcast the list on the radio. All sales were transacted using a "pay-as-bid" system.

ACDI immediately deposited deposit drafts for all winning bids to the proceeds account and refunded in full those of unsuccessful bidders.

Successful bidders received acceptance letters allowing them five business days to meet the balances due against their offers, and signed sales agreements. Buyers deposited payments directly to the ACDI/UCA proceeds account and, on presentation of a deposit slip issued by the bank, received delivery authorizations from ACDI. Buyers presented these delivery authorizations at the ACDI warehouse, lifted their goods, and signed delivery receipts.

The time that elapsed from tender call to delivery was approximately 15 days, or about five days from tender closing to delivery. ACDI conducted a tender cycle approximately every 21 days, selling 10,000 MT of vegetable oil over the first 18 months (approximately 400 MT per tender call) and earning a total of approximately $11 million in local currency.

Lessons Learned

ACDI's experience in Uganda demonstrates that in tender sales as in any commercial venture, it takes a certain amount of time to secure a place in the market. The PVO must invest considerable effort in building customer confidence in the product, the PVO, and its sales system, all of which may be new to commodity traders.

The first call for tenders yielded only 22 offers to purchase. Participation more than doubled to 50 bids in the second sale and jumped to 126 bids by the third sale. Participation fell off slightly in sales four and five but then climbed to 177 in sale six, 266 in sale seven, and 351 by sale eight. As the exercise progressed, participation stabilized at between 150 and 250 bidders in each sale (depending on prevailing market conditions).

Considering that the vegetable oil market in Uganda was essentially in the hands of only three firms before the ACDI P.L. 480 monetization program, the above participation figures, if taken at face value, appear impressive. Several factors must be kept in mind, however.

Because ACDI chose to use a pay-as-bid system, many bidders hedged their market positions by submitting multiple bids, bidding high to ensure supply, but also bidding low in the hope of snaring a bargain (and sometimes submitting a third bid in the mid range just to be sure). The actual number of traders regularly active in the ACDI program is estimated at about 100. Also in terms of tonnage, as opposed to the number of bids submitted, two of the three large traders represented nearly 50 percent of all purchases, with the remaining 50 percent spread over all other buyers.

The volume of bids and purchases from the small (one- to five-ton) buyers was sufficient, however, to sustain very strong competition and keep prices high. On several occasions one or both of the large traders failed to secure purchases because the cumulative purchases of smaller buyers (who consistently offered higher prices) exhausted the supply on offer before the bid of larger buyers (who consistently offered lower prices) was reached. It is also interesting that the third large trader (the parastatal Foods and Beverages Corporation) failed, despite several bidding attempts, to meet the competition and never succeeded in purchasing the ACDI P.L. 480 commodity.

On another front, ACDI discovered that requiring a 5 percent deposit worked well in weeding out the most frivolous buyers but created no disincentive to participation. Numerous small (and one large) buyers lost their deposits when they could not pay balances due within the time limit. Some bidders lost deposits on several occasions. Only once, however, did a dispute arise. In all other instances the buyers cheerfully accepted the losses as a cost of doing business, and most were back with a new bid in the very next tender call.

The ACDI program also showcased the private sector's inherent creativity and willingness to take risks. By the end of the first quarter (once again partly as the result of the pay-as-bid system), a small but enthusiastic category of high-risk buyers emerged. Entrepreneurs who had no distribution or marketing system, and who could not raise sufficient capital to purchase even the minimum of one lot (approximately $1,000), scraped together just enough money to make a deposit on a single lot (about $50). They then submitted a bid (or bids) at what they felt was likely to be the lowest price accepted.

This group became proficient at anticipating cut-off prices and more often than not had their bids accepted.

By the afternoon, when ACDI was to post the list of winning bidders, this group of 15 or 20 speculators crowded around the notice board. As soon as the list was posted, if they found themselves successful, they rushed to the ACDI sales manager to collect their sales agreements and acceptance letters. From the ACDI office they dashed to Kikubo Market (the principal center for commodity trading in Kampala), climbed on boxes in the center of the street, and held their own outcry auctions to sell their acceptance letters. Sometimes several such auctions were underway simultaneously.

On occasion these speculators failed to attract the prices required and lost their deposits to ACDI. Usually, however, they found buyers at prices yielding them a small profit on their ventures. ACDI only completed sales with the named bidder, but otherwise saw no reason, (or effective means) to discourage this commercial creativity.

For its part, ACDI exposed itself to considerable risk in undertaking to call forward and stock commodity before entering into sales agreements. This risk was mitigated, to some extent, by establishing a series of relatively small calls forward so that if sales did not materialize, commodity would not be shipped. As shown, however, sales took off relatively quickly, and ACDI proceeded with a regular call forward schedule.

About one year into the exercise, however, the Government of Uganda acted to limit a particularly virulent burst of inflation by sitting on its accounts payable, thus starving the local economy of cash. This policy was effective in checking inflation, but resulted in two very small back-to-back commodity sales for ACDI, followed by a third sale that fell completely flat.

Meanwhile, P.L. 480 commodity continued to arrive in Kampala, and warehouse space was exhausted. ACDI had to located additional storage space and lease it on very short notice, and inventory levels climbed to more than 3,000 MT (enough for at least six regular sales).

Fortunately, after two very unsettling months, the GOU eased its monetary policy, and ACDI resumed sales activities at substantial volume and value.

The ACDI Uganda monetization project demonstrated that even in the most difficult economic circumstances–high inflation, a devaluing currency, and little or no access to formal credit–the private sector can and will respond to opportunity and provide highly efficient food distribution and marketing.

The project also demonstrated the substantial impact P.L. 480 food commodities can have when used as capital in the private sector. A survey of 61 participating buyers conducted at the end of two years of operation showed that:

- 70 percent of the participating buyers were acting as individuals and did not represent an incorporated or registered company.

- 98 percent of the commodity purchased was resold (wholesale or retail) by the purchaser; 73 percent of the buyers marketing commodity resold at the wholesale level, with 27 percent being retailers.

- 30 percent of the buyers had never before traded in vegetable oil, and 42 percent reported having only done so on occasion.

- 52 percent made their payments in cash, as they had no bank account on which to draw checks.

- 57 percent of buyers financed purchases from their own resources, 26 percent used company funds, and 17 percent used borrowed funds.

- 87 percent reported always taking delivery of the commodity themselves, but 8 percent admitted to "sometimes" selling their option, and 5 percent reported "always" selling their option.

- 18 percent of the buyers reported forfeiting their deposit at least once, and 10% of the buyers reported forfeiting a deposit three or more times.

- 61 percent reported that their participation in the ACDI P.L. 480 monetization program had yielded sufficient profit to allow them to enter into some new area of business(sugar, flour, cigarette, or battery trade; putting up a building; opening additional shops; making larger vegetable oil purchases; undertaking poultry production; purchasing a taxi or a truck).

An independent evaluation conducted in 1991,at the end of the first two years of project activity, concluded that:

> "The Uganda monetization experience demonstrates the comparative advantage that business-oriented cooperatives and PVOs have over others in learning about and carrying out commodity sales. This lesson has important implications for broader A.I.D. monetization policies."

Chapter Nine

OPEN AND COMPETITIVE COMMODITY SALES–OPEN OUTCRY AUCTIONS[93]

After reading Chapter 9 and/or receiving training in the chapter material, one should be able to:

- *describe an open outcry auction*
- *list at least three advantages of open outcry auctions*
- *list three disadvantages of open outcry auctions*
- *discuss the timing of auctions*
- *list three reasons to place a maximum limit on sales to any one buyer*

9-1 Definition of Open Outcry Auctions

An open outcry auction is a sale conducted through a salesperson, called an auctioneer, who solicits bids on an item from an assembled group of prospective buyers in a public place. Although the term "auction" encompasses both open outcry auctions and sales by tender, for purposes of this manual, it will be used to refer only to open outcry auctions.

In an "English" auction, the auctioneer opens the bidding either by announcing a minimum price or accepting an opening bid from a potential buyer. The auctioneer solicits and encourages additional bids of increasing value from auction participants until no further bids are offered. The item being sold is then declared "sold" to the final and highest bidder. The procedure is repeated until the supply of items or lots offered for sale is exhausted or no satisfactory bids have been offered.

In a "Dutch" auction, the auctioneer begins with a maximum price and calls out decreasing prices to the assembled group of buyers until signaled to stop by a purchaser willing to pay that price. The auction then continues after each price acceptance, with ever-decreasing prices, until the items or lots are exhausted or the floor price has been reached.

9-2 Advantages of Sale by Auction

Title II commodities are sold less frequently by auction than by tender or negotiated sale. Sale by auction does, however, offer a number of advantages:

- Auctions represent another form of open and competitive sale.

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[93] Much of the material presented in this chapter has been reproduced with the permission of Save the Children. The material was first published in the *Save the Children Monetization Implementation Manual: a How-to Manual on Implementing Monetization Projects in the Field*, authored by Marine Overseas Services, Inc., and dated February 1993.

- Since sales prices are established through competition, auctions are ideal in situations where the CS may have difficulty establishing a fair market price.

- Given the public and open manner in which the sale is conducted, a well-run auction offers maximum transparency, eliminates questions of impropriety on the part of the CS, and builds confidence among buyers.

- By encouraging increased competition, auctions tend to yield prices higher than those obtained through negotiation.

- Commodity prices tend to be volatile, and the auction process allows bidders to respond to changes in commodity prices.

- Well-publicized auctions help identify and qualify potential buyers.

- By reducing paperwork, auctions generally require less administration and supervision than sales by tender.

9-3 Disadvantages of Sale by Auction

Below are some of the drawbacks associated with auctions:

- Local traders and processors are likely to be inexperienced with the auction process, and few qualified auction houses and auctioneers exist in developing countries.

- Auctions will not bring competition and yield high prices where the market is dominated by a small number of buyers.

- Auctions are not an efficient sales mechanism in markets heavily regulated by price controls.

- Licensed auction houses and auctioneers charge fees, usually calculated as a percentage of total sales value. The fees increase the cost of the sale and net less to the CS.

- In places where several local languages are spoken, auctions are difficult to conduct.

9-4 Timing of the Auction

Because the timing of auctions is important to their success, the CS should:

- Avoid carrying out an auction when the market is already well provisioned with the commodity to be monetized, either from local harvests or scheduled imports from other sources.

- Announce large-scale auctions as far in advance as possible (up to three months ahead of time) so that buyers can adjust their commodity import plans.

9-5 Transparency

The very nature of the auction assures maximum transparency, which is its greatest advantage. A CS must plan and operate its monetization sales system fairly, openly, honestly, and efficiently and must be perceived by outsiders to be doing so. Auctions ensure those elements of transparency and a high standard of execution.

A well-publicized auction will assemble all interested buyers at one time in one location where they will witness firsthand the process by which the sales price is established and successful buyers are selected.

The CS must plan all steps of the auction process in advance and then adhere to them rigidly. When it has established the timing and procedures for an auction, the CS should advertise them well in advance and then reviewed them in detail as the first order of business at the auction itself. Once the auction is underway, no changes or amendments to the announced procedures should be made.

9-6 Lot Size

Commodities should be offered for sale in lots (quantities) of a fixed size. A lot may be as large as an entire consignment or as small as the basic unit of commodity packaging. As a general rule, sales should be made in whole lots only.

Lot size should be set based upon the objectives of the CS who is selling the commodities. If the CS is attempting to increase competition and open markets to small buyers, then a lot size of 1-5 metric tons might be appropriate. In general, the smaller the lot size offered, the greater the number of bids that will be submitted, and the larger the number of successful bidders and individual sales that will be transacted. Smaller lot sizes usually produce greater sales revenue but create a somewhat heavier administrative burden.

If the CS is primarily concerned with generating the cash needed to fund its food security programs, it could set the lot size substantially higher.

9-7 Maximum and Minimum Purchases

In establishing the lot size, the CS has in effect established the minimum acceptable purchase. The auctioneer will therefore offer the commodity to the assembled buyers on the basis of the minimum lot size. When bidding ceases and a price has been accepted, the buyer can be asked the number of lots s/he wishes to purchase at that price.

The CS may wish to limit the total amount of commodity to be sold, in order to:

- impose some order on market prices by releasing fixed amounts of commodity into the market at regular intervals

- maintain a certain cash flow position in order to meet programming requirements and avoid currency losses due to inflation and devaluation while holding large sums of local currency on deposit

The CS may also elect to limit the total amount of commodity that can be sold to one buyer. By doing so, the CS will help to:

- prevent a single buyer from gaining control of the sale and market

- encourage development of small private traders and the small-scale private sector

Note that it is not always feasible to actually limit the total amount of a commodity that will be purchased by a single buyer because large buyers may bid through agents, family members, or other proxy representatives in order to circumvent the restriction.

At whatever level the CS sets the maximum amount of the commodity to be sold, the terms of the sale should clearly stipulate the amount of the commodity the CS is offering (total number of lots) but state that the CS reserves the right to sell less than that amount.

Sales should never exceed the amount offered in public announcements. Bidders have calculated their offers, in part, based on the total amount of the commodity they anticipate will be entering the market. If the CS sells more than the published maximum, it will be breaking faith with the buyers and placing them at risk of financial loss. This will be detrimental to future sales in terms of participation, prices offered, and ultimately proceeds generated.

9-8 Managing the Auction

The most difficult aspect of conducting monetization sales by auction is the actual management of the auction. CSs who have limited experience conducting auctions may wish to consider hiring the services of a qualified auctioneer or auction house.

9-9 Selection of Buyers

Once it commences, buyer selection becomes a function of the auction process itself. The highest bidder is automatically selected as a buyer.

Prior to starting the bid process, the CS must have procedures such as the following in place to screen potential buyers:

- Buyers should be qualified before bidding begins by having posted a deposit in the form of a letter of credit, bank guarantee, or certified bank check. At the end of the auction, the CS returns deposits that were submitted by unsuccessful bidders and retains the deposits of successful buyers as performance bonds.

- Potential bidders who have outstanding debts with the CS for prior sales should not be permitted to participate in the auction.

- The CS should have on hand an ample supply of sales agreements. These agreements should be designed in such a way that required information can be easily inserted (fill-in-the-blanks). Each buyer should sign a sales agreement immediately upon the close of each sale. (See Chapter 11 for more information about sales agreements.)

9-10 Payment Procedures

As soon as the auction is over and the sales agreements are signed, the CS should deposit proceeds into the monetization bank account.

Except for the aforementioned handling of the buyer's deposit, the CS should avoid directly handling instruments of payment. It should be an established and publicized element of the sales procedure that buyers themselves will directly deposit payments to the monetization proceeds bank account.

9-11 Delivery Procedures

The CS should not deliver the commodity until it has received full payment. The buyer should take delivery immediately after signing the sales agreement and making payment.

The CS should ensure that a delivery receipt, covering all aspects of quantity and quality of the commodity, is signed by the buyer when the commodity is transferred.

9-12 Procedure Review

Prior to conducting the auction, the CS should review the auction procedures with the following:

- an attorney, to ensure conformity with local law

- relevant government agencies and ministries, to ensure conformity with existing guidelines and policies and to ensure host government support

- the USAID Mission

- local businesspeople, as they will ultimately be the sales participants. The CS can ask members of the business community known to it to review the procedures. Furthermore, the CS can arrange a seminar for local businesspeople to discuss the monetization program, in particular the auction procedures. The local Chamber of Commerce could be another useful resource for the CS.

Chapter Ten

NEGOTIATED SALES[94]

After reading Chapter 10 and/or receiving training in the chapter material, one should be able to:

- *list four advantages and four disadvantages of conducting sales of Title II commodities through negotiation*
- *explain why, in some circumstances, a CS might have to sell commodities through negotiated sales rather than through an open and competitive process*
- *explain how to avoid issues of lack of transparency associated with negotiated sales*
- *discuss at least six principles a CS should follow when negotiating sales of Title II commodities*
- *explain why it is important for a CS to be able to delay or even walk away from a sale*

10-1 Definition of Negotiated Sales

Commodities are sold by negotiation when the seller meets with a qualified and interested buyer or buyers and reaches an agreement through offer and counter-offer.

10-2 Advantages of Negotiated Sales

Negotiated sales offer the CS several advantages, particularly when sales involve large quantities of commodities that are sold infrequently or commodities that, by their nature, will attract a limited number of buyers.

- Negotiated sales can result in lower operating costs through reductions in the costs of storage, transport, and staff.

- Because of the lead time involved in shipping, negotiated sales can provide the CS with advance knowledge of earnings from the sale, which simplifies program and budget planning.

- Generally speaking, negotiated sales are the most common, and therefore the most familiar, sales procedure for local buyers.

- Negotiated sales are the only effective means of sale in markets dominated by a single buyer or a small number of buyers.

- They are the only effective means of sale in markets that are heavily regulated in terms of price and other controls.

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10-3 Disadvantages of Negotiated Sales

Conducting commodity sales by negotiation also presents the following disadvantages for the CS:

- To negotiate effectively with local buyers, the CS must have an in-depth knowledge of commodities in general as well as of local commodity market conditions.

- Negotiated sales offer limited competition and may result in lower sales prices.

- Proceeds are often generated in larger amounts at one time, thereby increasing the risk of loss in the value of sales proceeds through inflation and devaluation.

- Negotiated sales tend to reduce transparency and raise concerns and questions regarding the propriety of sales.

- Because of the extended time involved between negotiation and actual receipt of the commodity by the buyer, an additional risk factor involving the actual future import parity price is assumed by the buyer. The buyer recognizes this and often hedges that risk by reducing the price s/he is willing to pay.

10-4 Timing of the Negotiated Sale

If the number of potential buyers is limited to one or only a few, then the timing of the sale becomes a crucial factor. Any potential buyer who knows that a commodity is forthcoming and that s/he is the only customer will be able to hold out for a very low price.

In order to negotiate from a position of strength, the CS should avoid calling forward unsold commodities. Negotiations should be concluded, sales agreements signed, and financial guarantees in place before the commodity is called forward. At the latest, the sale should be completed before the commodity is lifted at the U.S. port.

The CS should keep in mind that negotiations may be drawn out, involving a series of sessions over an extended period of time. This is especially likely in societies where negotiation is regarded as a combination of art form, business, social function, and entertainment. In short, the CS should plan ample time for negotiations; time constraints will only place the CS at a distinct disadvantage in the negotiating process.

10-5 Transparency

Of the sales options open to the CS, the negotiated sale has the disadvantage of offering the least transparency. This can be mitigated by undertaking widespread advance publicity designed to encourage all potential buyers to take part in the monetization program. Such publicity is important even when only one or two qualified buyers are likely to respond.

In countries where an umbrella monetization agreement is in place, the lead agent may wish to involve the other CSs in the negotiating sessions. This may demonstrate to the buyer the seriousness of the process and protect the lead agent from appearing isolated.

The CS should be sure to take careful notes at each negotiating session and hold the notes in a secure file.

10-6 Lot Size

The lot size will usually be established during the negotiation itself. If only one potential buyer is involved, the lot size will in effect be set by the buyer's offer and his/her financial ability to pay for, store, transport, and market the commodity. This will apply even when the CS undertakes negotiations simultaneously with more than one buyer. Each buyer will establish the total amount of the commodity s/he plans to purchase.

10-7 Maximum and Minimum Purchases

In negotiated sales involving only one or a very few buyers, the maximum purchase will be determined by the amount of Title II commodity the CS is offering and the amount the buyer wishes to purchase or is capable of purchasing.

The minimum purchase will be the smallest amount the CS considers worthwhile to sell when it compares management costs to proceeds to be earned. Shipping considerations, such as minimum cargo sizes on bulk commodities, may also factor into the CS's decision on minimum purchases.

10-8 Managing Negotiations

Face-to-face negotiations with an individual buyer can be one of the most difficult challenges in the monetization process. There are no hard and fast rules for this exercise, and even such guidelines as can be offered are subject to local customs and conditions. In general, however, the CS should keep the following in mind:

- **Know your negotiating position**. Before facing a prospective buyer, the CS must know its sales price requirements and its degree of flexibility in terms of price, timing of arrivals, lot size, and minimum and maximum purchases. The CS must always be prepared to back away from a sale if it cannot negotiate an appropriate deal.

- **Know your commodity**. Wheat is not simply wheat, and vegetable oil not simply vegetable oil. Each commodity has a wide variety of technical characteristics and sources of supply. The CS negotiator who does not understand these factors will be at a distinct disadvantage. In addition, P.L. 480 commodity specifications may not be identical to grades and standards used in other commercial transactions. Discrepancies can result in serious misunderstandings if buyer expectations are not met. This, in turn, will undermine future negotiations because the CS will appear to be an unreliable supplier.

- **Know your buyer.** In advance of negotiations, the CS should learn everything it can about the local commodity market and, specifically, about the business activities of the prospective buyer(s). This is not an easy task. However, every piece of information the CS has, including knowledge of local customs and culture, represents an advantage..

- **Timing is everything**. The best time to negotiate is determined by the commodity's availability in the local market, the anticipated arrival time of imports, and local production. Scheduling negotiations when the commodity is not available or is in short supply will place the CS at an advantage. The CS should avoid entering into negotiations when it is pressed for time.

- **Use a familiar negotiating format**. Negotiations should be conducted in the format that is most frequently utilized in the host country. Offers should be confirmed in writing.

- **Negotiate with authorized parties**. Transactions should be negotiated directly with the buyer or with a representative of the buyer who has the authority to make a deal.

- **Personalize the process**. The person negotiating for the CS should establish a face-to-face, personal relationship with the buyer. There is no substitute for personal contact, which stimulates trust between the two parties.

- **Be cautious**. The CS should ensure that everything concerning the sale is recorded in writing.

- **Share the win**. At the outset, and throughout the negotiation process, the CS negotiator should openly express his/her desire to reach an agreement that will benefit both parties. The goal is to sell at a fair price, one that will both meet the CS's objectives and allow for a fair profit margin for the buyer.

- **Be polite but firm**. A CS representative who is considerate and polite, even while negotiating with vigor, will get more out of the buyer.

- **Act knowledgeably**. Buyers respect experts. The CS negotiator should be well-versed in all aspects of the sale. At the same time, s/he should respect the buyer's expertise. The buyer almost certainly has superior knowledge about local commodity trading.

- **Ask questions**. To better understand the buyer, the CS negotiator should ask a lot of questions. This is one way to learn a great deal and to foster a positive negotiating climate.

- **Listen politely**. The buyer's positions or offers should never be rejected out of hand. The CS negotiator should note anything in the buyer's statements with which s/he agrees and then restate his/her position.

- **Establish the agenda**. A draft sales agreement can be used as a negotiating tool. A buyer often agrees more readily to something already in . Demands should be moderate, and the CS should negotiate incrementally.

- **Be bold in pricing**. The CS should strive to negotiate the highest sales price possible, keeping in mind at all times the cost recovery benchmark and the importance of import parity pricing. The buyer will most likely offer less than s/he believes the commodity is worth. Knowledge of the local market price structure will enable the CS negotiator to counter an unacceptable bid.

- **Use objective criteria**. Negotiations should be structured around facts, figures, and known precedent in the local commodity markets.

- **Hang back**. The CS negotiator should strive to have the buyer make the first offer.

- **Be aware of time pressure**. Patience and persistence are important. However, if negotiations are proceeding too slowly, a deadline should be set, even an artificial one. On the other hand, ultimatums should be avoided.

- **Give and take**. Issues should be combined if the buyer is likely to agree to at least one of them. The CS should never give something up unless the buyer gives something in return. Concessions should be small but presented to the buyer as big.

- **A signed seal is a closed deal**. The sales agreement should be signed immediately upon the close of negotiations.

- **Boost the buyer's morale**. The buyer should be made to feel good at the close of the negotiations so that s/he will be amenable to doing business again.

10-9 Selection of Buyers

When the CS has been forced to negotiate with only one or two qualified buyers, it should use the same criteria for screening potential buyers. If the commercial environment is so unfavorably compromised that the CS cannot negotiate a satisfactory deal with a responsible buyer, then the CS should question whether it is an appropriate market in which to monetize.

10-10 Payment Procedures

Upon completion of negotiations, the buyer must agree to post a letter of credit, bank guarantee, or deposit, either fixed or a percentage of the total sales value. This should be done at the time the sales agreement is signed or as shortly thereafter as practicable. Delays may occur in securing the financial instrument due to the financial institution's unfamiliarity with the instrument required, e.g., a letter of credit denominated in foreign currency, etc.

The CS should avoid directly handling instruments of payment. It should be an established and publicized element of the sales procedure that buyers will place their deposits and final payments directly into the monetization proceeds bank account.

10-11 Delivery Procedures

Delivery of the commodity should not be made until the CS has received payment in full. (See footnote 80 for a discussion of the term "payment in full.") Particularly in negotiated sales, the buyer should take delivery as early in the commodity arrival process as possible. Ideally, this will mean at the port at the end of ship's tackle. By passing title to the buyer at the earliest possible time, the CS passes on potential handling, transport, and storage losses.

A delivery receipt, covering all aspects of quantity and quality, should be signed by the buyer at the time of delivery.

10-12 Procedure Review

The CS should study all aspects of the local market, including traditions, customs, and regulations, that might have an impact on negotiations. Guidance from the following sources may prove useful: local attorneys, relevant host government agencies, the chamber of commerce, local businesspeople (other than those who are potential buyers), the USAID Mission, the U.S. Embassy Commercial Attaché, and any local representation of a U.S. commodity association. After each negotiated sale has been finalized, the CS should review its performance and assess whether to modify tactics, strategies, or procedure.

10-13 Notes on Negotiated Sales

Negotiating an acceptable sales price may prove difficult or even impossible if the CS has only one or very few qualified buyers and if commodity prices are held below world market prices through price controls, subsidies, or over-valued exchange rates.

Although market and price surveys carried out while the CS was developing the monetization project proposal should have provided a reasonably accurate idea of what price offers to expect, local market forces and world commodity prices fluctuate. Despite the considerable resources and time invested, the CS should be prepared to cancel a sale if it cannot obtain an acceptable price, and should advise potential buyers that it is prepared to do just that.

The CS must not appear overly eager to sell. The CS should be prepared to delay calling forward a commodity when the cost recovery benchmark cannot be met.

Chapter Eleven

SALES AGREEMENTS AND PURCHASER PAYMENT

After reading Chapter 11 and/or receiving training in the chapter material, one should be able to:

- *list at least six standard provisions to be included in every sales agreement*
- *name the various parties required to finalize a sales agreement*
- *state the optimal timing for execution of a sales agreement*
- *explain the purpose of a performance bond*
- *discuss the various instruments through which payment for commodities can be made*

11-1 Sales Agreements

A sales agreement is the document that spells out the terms and provisions of a Title II commodity sale. A sales agreement is executed by both the buyer and the seller and must be in place for each and every sales transaction.[95]

11-1.1 Standard Provisions

The MFM states that the CS should include the following essential provisions in all sales agreements[96]:

1) full commodity specifications and tonnage
(This information would include the type of commodity that will be delivered, including the quality specifications of the commodity, and the amount sold, expressed in number of metric tons and number of lots, as appropriate.)

2) agreed total sales price. A discount range should be specified in the agreement in order to prevent failure of performance on the part of the buyer in the event that the commodities do not meet the agreed upon specifications.

3) how and when payment(s) will be made, amount(s) of payment(s), terms of payment(s) (including a description of the terms), if applicable, exchange rate used (including whether it is a market-based rate) and when used (e.g., at the time of payment, at the time of signing the agreement), and a guarantee that payment will

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[95] The Grain & Feed Trade Association (GAFTA) and the National Oilseed Processors have developed standardized contracts for trade in their respective commodities. CSs who wish to learn more about these associations and their standardized contracts can read about them on the Internet at www.gafta.com and www.nopa.org.

[96] *Monetization Field Manual: P.L. 480 Title II Programs,* Office of Food for Peace (USAID), October 16, 1998, Section VI.E. of the Implementation Guidelines. The explanatory notations shown in parentheses and italics are not part of the MFM.

take place. In no case should title to or possession of the commodities pass to the buyer until payment in full has been received by the CS.[97]
(This information would include the currency in which the sale is denominated; the payment schedule and size of payment tranches, e.g., 50 percent upon signing and 50 percent when the commodities are delivered; the terms of the payment, e.g., irrevocable letter of credit; the exchange rate used and how and when the exchange rate was determined; and a guarantee that the buyer will pay for the commodities.)

4) statement of purchaser's capability to take delivery of, properly store, and successfully market the commodities in-country

5) stipulation that the purchaser will not export the commodities or products thereof

6) agreement by purchaser, having accepted the commodities when discharged at the port of entry, not to raise claims thereafter about the "wholesomeness" or "fitness" of the commodities

7) date of sale

In addition to the provisions recommended in the MFM, the sales agreement should also include the following elements:

8) the complete names and addresses of the parties to the agreement.

9) how the sale will proceed, i.e., which documents need to be transferred based on the performance of which actions.

10) responsibilities for each of the many tasks that need to be performed, e.g., inspection, transport, handling, customs, taxes, and safeguarding.

11) how the contract will be enforced, i.e., define the terms of arbitration, name the independent third party, and establish the conditions that trigger such recourse.

12) the penalties for the buyer's late payment. In theory, however, a buyer's payment should never be late. If payment is to be made in cash or by cashier's check, the payment should be made up-front. If payment is not made in accordance with the terms of the sales agreement, the bank guarantee is activated. With a letter of credit, the seller is paid immediately upon presentation to the bank of the documents stipulated in the sales agreement.

13) stipulation that the buyer can not sell the commodities to the military

14) a description of the commodity packaging

[97] See footnote 79 for a definition of "payment in full."

15) provisions for amendment, given mutual agreement

16) *Force Majeure* clause, which nullifies the seller's obligation to deliver commodities in situations where "acts of God," e.g., hurricanes, ships lost at sea, occur[98]

11-1.2 Executing the Sales Agreement

11-1.2.1 Signers

The field office director or the director's designate should sign the sales agreement n behalf of the CS. The signer must have the authority to enter into legally binding agreements on behalf of the CS. In the case of an umbrella monetization, the lead agent should sign the sales agreement after the umbrella monetization committee has approved the provisions.

The CS (or lead agent) should ensure that the person signing on behalf of the buyer has the authority to do so.

11-1.2.2 Timing of Execution

The sales agreement should be signed immediately upon consummation of the sales transaction, or as soon thereafter as possible. For negotiated sales, the CS representative should have a sales agreement on hand and ready to be signed when s/he meets with potential buyers. The buyer may not agree with all the terms of the agreement, and some redrafting may be required. But, by immediately proffering a sales agreement, the CS representative will send a signal that the deal is done and that s/he expects to finalize an agreement quickly.

For tender sales and auctions, the sales agreement should be made part of the information packet that is provided when the sale is publicized. This will allow potential buyers to review the agreement and seek clarification from the CS before the date the tenders are due or the auction takes place. Sales agreements should be signed with purchasers as soon as their bids are accepted.

11-2 Purchasers' Payment[99]

11-2.1 Procedures for Payment

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[98] Provisions 9-14 are taken from *Monetizing Food Aid - 1993 - A Guide for PVOs*, Food Aid Management, November 1993, Chapter 18.

[99] Much of the material presented in this section and the sections that follow has been reproduced with the permission of Save the Children. The material was first published in the *Save the Children Monetization Implementation Manual: a How-to Manual on Implementing Monetization Projects in the Field*, authored by Marine Overseas Services, Inc., and dated February 1993.

A detailed explanation of payment procedures should appear both in the original announcement of the sale and in the sales agreement. The recommended forms of payment are:

- irrevocable letter of credit
- bank guarantee
- certified check
- cash

It is strongly recommended that the CS obtain a performance bond prior to submitting a call forward. The MFM states, "The performance bond should equal at least 10 percent of the expected sales price and be denominated in the currency in which the sale will take place. The bond should take the form of an irrevocable letter of credit (or similar instrument, in accordance with local practices) and guarantee payment to the CS of the amount of the bond in the event that the buyer of the Title II commodities fails to perform in accordance with the sales agreement."[100]

When a series of cash payments are scheduled, the commodity should be delivered in installments directly corresponding to the payment schedule. This ensures that only the amount of commodity that has been paid for is delivered, and that responsibility for the commodity that has been paid for passes to the buyer.

11-2.2 Payment Instruments

Buyers can pay for commodities through several secure instruments that assure collection of full payment by the CS. Each payment instrument has its own inherent advantages and disadvantages. The most common forms of secure payment instruments are letters of credit, bank guarantees, and certified checks. These are discussed below.

11-2.2.1 Letters of Credit

> *A letter of credit (L/C) is a document issued by a bank through which the bank agrees to pay to the seller, on the buyer's behalf, a specified amount of money upon presentation of certain documents to the bank within a predetermined time frame. The seller named in the letter of credit accepts the bank's reputation and credit as security for the payment, and the bank assumes the risk associated with the buyer's credit.*

L/Cs are either *revocable* or *irrevocable*. Revocable L/Cs can be canceled or amended at any time without prior notice to either party. CSs cannot, therefore, rely upon revocable L/Cs as an assured form of payment. Irrevocable L/Cs, on the other hand, cannot be amended, canceled, or changed in any way without the consent of the buyer, the seller, and the bank. Therefore, the CS should accept only irrevocable L/Cs.

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[100] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section VI.B. of the Implementation Guidelines.

A CS may wish to reinforce an irrevocable L/C by having it confirmed. An irrevocable L/C is confirmed when the CS's U.S. bank guarantees payment by adding its own obligation to that of the issuing bank. By offering confirmation, the U.S. bank places its credit and guarantee ahead of those of the issuing bank. The CS is thereby protected against delays or any other risk which might be associated with a foreign bank.

<u>Advantages of Using a Letter of Credit</u>

The greatest advantage of L/Cs is their flexibility. Each L/C is designed to address needs unique to the parties involved and incorporates conditions and requirements for documentation agreed to by both the buyer and the seller.

1) Advantages for the CS:

- L/Cs guarantee payment by the bank and thus eliminate the risk of non-payment.

- The CS receives payment in full upon presentation to the bank of documents stipulated in the sales agreement.

- L/Cs eliminate financial and political risks in countries with unstable governments and economies, particularly when the L/C is confirmed by the CS's U.S. bank.

2) Advantages for the buyer:

- L/Cs guarantee that the seller will ship the commodity as set out in the agreed terms of the L/C, since shipping documents must be presented before payment can be made.

- LCs provide a financing mechanism through which the buyer's bank can finance all or part of the purchase.

- LCs reduce the amount of foreign currency required to post a cash deposit.

<u>Disadvantages of Letters of Credit</u>

In some cases, bank policy prohibits the issuance of L/Cs denominated in the currency of the host country. Furthermore, since in developing countries L/Cs are used almost exclusively for the purchase of imports with hard currency, even a bank that is prepared to issue an L/C in the host country's currency might have little or no experience in doing so. Finally, the cost to the seller of securing an L/C can be prohibitively expensive. The usefulness of L/Cs will depend upon bank policy and commercial practices in a given country.

Documentation

Banks that issue L/Cs will pay only upon presentation of stipulated documents that are in good order. Banks will neither verify the quality of merchandise nor inspect a ship. They are responsible only for determining that the documentation appears to meet the terms set out in the L/C. The CS must, therefore, ensure that all documents are correct and complete in every detail.

The quantity and quality of the commodity shipped ultimately depends on the integrity of the sellers (for purposes of this manual, the CS and the U.S. Government). Buyers therefore must have considerable confidence in the CS to go forward with a purchase.

A buyer can verify that the commodity shipped conforms with the specifications spelled out in the sales agreement by reviewing inspection certificates that have been issued by USDA. Inspection certificates usually must be presented before banks will remit payment on L/Cs; the CS must be aware of which certificates are required. The buyer can also arrange for an independent inspection firm to examine the commodity prior to shipment.

Amendments to Letters of Credit

Banks are obligated by the terms and conditions of the L/C and do not concern themselves with other contract stipulations that are either different from or in addition to the documents required to meet the terms of the L/C.

Any discrepancy between the terms of the L/C and the sales agreement could nullify payment. Therefore, the CS must ensure that each and every detail is correct, including such questions as spelling, the use of “Co.” in place of “Inc.” or “Ltd.,” and the manner of typing the date (month/day/year vs. day/month/year). Even a typographical error or misplaced punctuation mark found after issuance will mean the L/C must be amended.

Should either the CS or the buyer realize that a term or condition of the L/C cannot be met, the L/C must be amended immediately. Amendments cannot be left until shipping documents have been prepared and forwarded to the bank, as banks act upon terms in effect upon receipt of documentation.

Amendments can be used to alter any term in the L/C, such as the value of the credit, the expiration date, shipping terms, or documentary requirements.

Amendments must be agreed to by all parties to the L/C: the buyer, the CS, and the bank. Only with such mutual agreement can the changes be validated. For confirmed L/Cs, the confirming bank must also concur with the amendment language.

Checklist for Letters of Credit

As soon as the CS receives an L/C, the staff person responsible must review its terms and conditions to confirm the CS's capability to meet its requirements. The L/C is only as good as the CS's ability to comply with all its conditions within the time allowed.

Checklist for Reviewing a Letter of Credit (L/C)

- ☐ Is the L/C irrevocable?
- ☐ Are the CS's name and address accurate?
- ☐ Are the buyer's name and address accurate?
- ☐ Does the L/C include the amount or value, including the exchange rate used?
- ☐ Does it include the terms of the sale?
- ☐ Is there a possibility of additional charges? (Does it say "approximately" or "about" and, if so, to what extent may the amount vary?)
- ☐ Does it include the location of the paying bank, i.e., where the credit is available?
- ☐ Is the credit negotiable, i.e., can it be transferred to another party?
- ☐ Does it stipulate which documents must be presented by the CS?
- ☐ Is the commodity described exactly and accurately?
- ☐ Does it state the unit price?
- ☐ Does it include the shipping terms?
- ☐ Does it include the points of loading and destination?
- ☐ Are there any stipulations for partial shipments and transshipments?
- ☐ Are there any special instructions?
- ☐ What is the expiration date?
- ☐ Is the L/C confirmed or not?
- ☐ Is the L/C subject to Uniform Customs and Practices for Documentary Credits (UCP)?

11-2.2.2 Bank Guarantees

A bank guarantee, also referred to as a contract guarantee, is a document issued by a bank in which the bank agrees, on behalf of the buyer (sometimes referred to as the "principal"), to ensure that all obligations set forth under a contract, including payment in full, will be met by the buyer, provided the seller (sometimes referred to as the "beneficiary") demonstrates full discharge of his/her obligations through presentation of specified documents within a predetermined time frame.

Bank guarantees can be as comprehensive as necessary, and can include any term or condition that is agreeable to all parties: the buyer, the CS, and the guaranteeing bank. They can apply to deposits only, or they can cover the total value of the sale.

Bank guarantees can be amended at any time, provided the amendments are agreed to by the buyer, the CS, and the bank. Bank guarantees cannot be amended without the agreement of all parties.

Advantages of Bank Guarantees

Like a letter of credit, a bank guarantee offers considerable flexibility. Each guarantee can be tailored to fit the demands of a P.L. 480 monetization program and its particular requirements.

1) Advantages for the CS:

- A bank guarantee assures that payment will be made. The CS should activate the bank guarantee if a buyer fails to make payment according to the agreed-upon schedule.

- A bank guarantee provides credit facilities to a buyer without exposing the CS to risks of non-payment.

2) Advantages for the buyer:

- A bank guarantee ensures that payment is not made until the commodity is delivered.

- A bank guarantee provides a financing mechanism through which the buyer can obtain credit.

- A bank guarantee permits the buyer to purchase the commodity in the currency of the host country.

Disadvantages of Bank Guarantees

- Banks issuing guarantees deal in documents only. The issuing bank will pay only upon presentation of the documentation set out in the original guarantee. The bank will not verify the quality of the merchandise or inspect a shipment. The CS must, therefore, ensure that all documents presented are correct and complete in every detail.

- The buyer must pay a fee in order to obtain a bank guarantee.

Documents most often required by bank guarantees

- Ocean Bill of Lading
- Certificate of Origin
- Commercial Invoice
- Independent Surveyor's Report

- Inspection Certificate
- Delivery Receipt

Amendments to Bank Guarantees

Banks are obligated only by the terms and conditions of the guarantee and do not concern themselves with contract stipulations different from or in addition to the documents required to meet the terms of the guarantee. If, after the bank guarantee is issued, discrepancies are found between the terms of the guarantee and those of the sales agreement, either the buyer or the CS must amend the bank guarantee. Amendments are made, however, at the discretion of the bank.

11-2.2.3 Certified Checks

A certified check is a check that has been drawn by the buyer against his or her own account and guaranteed by the bank's assurance that sufficient funds are on deposit to cover the check's payment.

Advantage of Certified Checks

The CS is guaranteed payment of the value of the certified check, qualified only by the dependability of the bank issuing the certification.

Disadvantage of Certified Checks

Because a buyer must have sufficient funds on deposit to obtain the certification, certified checks provide no credit terms to the buyer. The CS should confirm the clearance of a certified check from the buyer's account to the CS's account.

11-2.3 Collateral Management

Collateral management is another payment mechanism that is being used with greater frequency in monetization transactions. Under a collateral management arrangement:

- The buyer delivers the commodity to its own storage facilities and stores it there, paying storage, security, fumigation and other related costs.

- The CS secures the storage facilities with its own seals and locks. The buyer does not have access to the commodity.

- The CS continues to hold title to and ownership of all the commodity until such time as the buyer pays for it (in tranches).

- The buyer pays for and then draws down on the commodity. The buyer pays only for the portion drawn down.

- The sales agreement stipulates that the buyer must draw down a designated amount of the commodity within a specified time frame or pay for the commodity anyway.

- A bank guarantee may or may not be in place. Collateral management is often used when bank guarantees and letters of credit are prohibitively expensive or unavailable. The CS is "secured" in that it retains ownership of that portion of the commodity that the buyer has not paid for.

Chapter Twelve

MANAGING MONETIZATION PROCEEDS

After reading Chapter 12 and/or receiving training in the chapter material, one should be able to:

- *list at least five internal controls that should be in place to safeguard monetization proceeds*
- *discuss the CS's role with respect to monetization proceeds that have been transferred to a host country counterpart*
- *explain the concept of inflation and how it can affect a monetization budget*
- *explain the concept of currency devaluation and how it can affect a monetization budget*
- *explain the rules associated with selling commodities in a hard currency and converting foreign currency proceeds into hard currency*

12-1 Overview

CSs must ensure that monetization proceeds are safeguarded against theft, misappropriation, and misuse. Furthermore, as far as possible, the value of monetization proceeds must be protected against inflation, depreciation, and devaluation.

Chapter 3 of this manual describes USAID's expectations regarding a CS's ability to safeguard monetization proceeds. The following sections explain in greater detail the measures a CS should take to protect this valuable asset.

12-2 Internal Controls

Monetization proceeds are vulnerable to theft, misappropriation, and misuse. To safeguard against possible losses, the CS should have in place strict procedures for depositing, tracking, and expending these proceeds. The CS should implement and strictly adhere to the following policies:

- No one employee should be permitted to handle from beginning to end a transaction involving monetization proceeds.

- Those employees who receive and/or disburse monetization proceeds should not be responsible for recording these transactions or for reconciling bank statements.

- Ideally, the buyer of commodities will deposit monetization proceeds directly into the account set up solely for this purpose.

- If the buyer remits cash to the CS, the CS should issue a pre-numbered receipt and retain a duplicate. Someone who neither collects nor disburses cash nor reconciles the bank statements should deposit the cash in the bank before the end of the day.

- A management-level employee who is familiar with the allowable uses of monetization proceeds should authorize all disbursements.

- Disbursements of monetization proceeds should be made by check.

- A person not involved in the cash receipt or disbursement process should prepare bank reconciliations. A management-level employee, other than the one who authorizes disbursements, should review reconciled bank statements.

- The CS should compare receipts and disbursements of monetization proceeds with amounts budgeted and investigate significant variances.

12-3 Monetization Proceeds Accounts

In order to ensure the proper application of funds, accountability, and transparency, Regulation 11 requires that a "special interest-bearing account [be] established by the cooperating sponsor for monetized proceeds."[101] Where several CSs participate in an umbrella monetization, each CS should establish its own account and deposit only monetization proceeds into this account.

If, for whatever reason, a CS is prohibited from earning interest on its monetization proceeds bank account, it must provide an explanation to FFP.

12-4 Assessing Commercial Banks

Choosing a reputable and solvent bank is an important step the CS should take to protect the safety of its monetization proceeds. Steps for assessing the credibility of a local bank are outlined below:[102]

- The CS should survey the local business community, especially food importers and commodity traders and processors, to determine where local businesses conduct their banking business. This is a good indicator of a given bank's experience, integrity, solvency, and service capability. The CS can ask local businesspeople for their opinions and evaluation of various banks. Opening an account where potential buyers

[101] 22 CFR Part 211, Section 211.5(j). In Appendix I Section 3, 22 CFR Part 211 refers to a "special (segregated), interest bearing account." FFP policy requires that the CS establish a *separate* interest-bearing account for the deposit of monetization proceeds. Any deviation from this policy requires prior consultation with FFP/W.

[102] *Save the Children Monetization Implementation Manual: a How-to Manual on Implementing Monetization Projects in the Field*, Marine Overseas Services, Inc., February 1993, Section 8.2.

do business may make it easier for the buyers to obtain letters of credit and bank guarantees.

- The CS may ask the local chamber of commerce whether it offers ratings of local banks and bank services.

- The CS can ask the central bank, which governs the operations of commercial banks, to evaluate and recommend local banking services.

- The U.S. Embassy, USAID Mission, and other U.S. concerns operating in the country may be able to recommend a reputable bank.

- The CS should ask each bank under consideration to provide an audited annual report as well as up-to-date financial statements and should examine these documents to evaluate the bank's institutional viability.

- From the information obtained in the above steps, the CS should be able to decide which banks can be depended upon to provide accurate and timely monthly statements and to provide prompt interim statements on request.

In deciding which bank to conduct business with, the CS should also consider the following:

- the bank's ability and willingness to offer letters of credit or bank guarantees to buyers wishing to participate in monetization transactions

- the rates of interest the bank offers on funds on deposit

- the length of time the CS must commit funds in order to maximize interest earnings

- the bank's ability to meet a CS's call for large sums, possibly in cash, on short notice

- the availability of deposit insurance and the maximum amount that can be insured

- the reputation of the bank's officials (A bank's performance can, to some extent, be judged by the people running it.)

The CS should document in writing any non-standard service that a bank offers in order to secure the CS's business.

Finally, where feasible, the CS should consider establishing a monetization account at more than one bank for the following reasons:

- Buyers are served better by expanding the number of banks available to them.

- The CS will avoid losing all its monetization funds if a bank fails, or losing access to those funds if the bank is unable to meet its short-term obligations.

- A single bank may not be able to insure large sums of monetization proceeds.

12-5 Monetization Proceeds Transferred to Host Country Counterparts

CSs retain liability for monetization proceeds that are transferred to host country counterparts (referred to in Regulation 11 as "recipient agencies") who cooperate in the implementation of Title II project activities. Before transferring monetization proceeds, the CS should therefore ensure that:

- Counterpart staff have been adequately trained to account for, disburse, and report on monetization proceeds.

- A Recipient Agency Agreement is in place that:
  - describes the approved uses of monetization proceeds;
  - requires the counterpart to reimburse the CS for monetization proceeds that are used for purposes not permitted under the Recipient Agency Agreement or that are lost or misappropriated as a result of the counterpart's failure to exercise reasonable care with respect to such monetization proceeds;
  - incorporates the terms and conditions of Regulation 11.

- A plan is in place for monitoring the counterpart's compliance with the terms of the Recipient Agency Agreement.

12-6 Erosion of Purchasing Power

Inflation, currency depreciation, and currency devaluation negatively affect the purchasing power of a country's currency. These three phenomena are discussed below, followed by measures for mitigating their impact.

12-6.1 Inflation

Most countries, to a greater or lesser extent, experience inflation. Inflation is a sustained increase in the overall level of prices within an economy. As prices rise, the purchasing power of a unit of currency declines. This means that the monetization proceeds that a CS has on hand during a period of inflation will buy less and less over time. The CS must take steps to minimize the loss of purchasing power resulting from inflation.

- The CS should invest monetization proceeds in an interest-bearing account, ideally one that pays interest at a rate higher than the inflation rate.

- The CS might consider conducting multiple commodity sales throughout the year, as cash is needed, rather than selling commodities in one (or a few) large transaction(s). The CS would need to consider the additional administrative costs it would incur as well as the importance of timing the commodity sales to coincide with the country's pre-harvest seasons.

- The CS should consider procuring capital equipment and other costly items immediately after monetization proceeds are received. "Wherever possible, [the CS should] coordinate receipt of sales proceeds with the timing and magnitude of operational purchases, so that local currency is spent quickly after receipt. When the majority of proceeds must be received at the same time, [the CS should] delay payments for items already purchased, and contract for future goods and services in advance of their actual requirement. Careful management will reduce the time that sales proceeds remain in a bank account and allow for purchase at current prices rather than later higher ones."[103]

- In a country experiencing hyper-inflation, the CS might require payment for monetized commodities in a hard currency, one that is not losing value as a result of inflation. Alternatively, the CS might accept payment in the buyer's currency and then immediately convert the proceeds to a hard currency. (The role of hard currency in the monetization process is discussed in greater detail in Section 12-7.)

12-6.2 Currency Depreciation/Devaluation

Currency depreciation occurs in economies where the exchange rate is allowed to "float" or fluctuate, and currency devaluations occur in economies where the exchange rate is "fixed," i.e., pegged to the value of another currency. Both depreciation and devaluation result in a decline in the value of a currency vis-à-vis other currencies. What is of interest to the CS is the effect that currency depreciation or a devaluation can have on its cost recovery objectives and on its monetization budget.

Currency depreciation and devaluation can also be detrimental to a CS's monetization budget in that they almost always lead to price increases on imported goods. If a large portion of the CS's monetization proceeds are budgeted for the purchase of imported goods and services, and the host country government devalues the country's currency, then the CS will likely be left with a budgetary gap. The example in the box below describes this scenario.

[103] *Ibid.*, Section 8.3.3.

How can currency devaluation affect a monetization budget?

In a purely hypothetical situation, a CS implementing a Title II program in Peru has just monetized several thousand metric tons of commodities. The buyers have remitted payment, and now the CS has the cash it needs to purchase the Ford Bronco that was budgeted for. Unexpectedly, the government of Peru devalues the currency by 10 percent. Because of the devaluation, the Ford Bronco, which cost 125,000 *soles* at the time the budget was prepared, will now cost more than 137,500 *soles*. The value of the currency following the devaluation is 10 percent less vis-à-vis the dollar, so it will now take approximately 10 percent more *soles* to purchase the vehicle.

In order to avert cost recovery and budgetary problems brought on by currency depreciation and devaluation, the CS should:

- Follow the recommendation outlined in Chapter 7: always sell commodities as far above the cost recovery benchmark as possible, so that if the currency depreciates or is devalued between the time of the call forward and the time the buyer remits payment, cost recovery objectives might still be met.

- Adhere to the policies suggested above for dealing with inflation.

- Whenever possible, procure goods and services that are produced locally. Currency depreciation and devaluation have a far greater impact on the prices of imports than on the prices of domestic goods and services.

- Consider depositing monetization proceeds in a hard currency-denominated account.

12-6.3 Losses Sustained as a Result of Currency Fluctuation

Concerning losses sustained as a result of currency fluctuation, the MFM states, "for . . . any loss due to currency fluctuation that [is] expected to have a negative programmatic impact, the CS must submit a written report detailing the circumstances of the loss. The CS may request additional commodities to compensate for the shortfall of monetization proceeds resulting from the loss. Provision of commodities is not automatic and consideration will be given only after written justification from the CS is provided. Limitation of funds . . . may be a factor in BHR/FFP's consideration of any replacement."[104]

[104] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section VIII.B.2. of the Implementation Guidelines.

12-7 Monetization and Hard Currency

For buyers in developing countries, one of the benefits of purchasing Title II vs. commercially imported commodities is that Title II commodities can be paid for with the currency of the host country. Many, if not most, buyers do not have ready access to foreign exchange, so the advantage of being able to pay for commodities in the buyer's own currency is a significant one.

Under certain circumstances, however, the CS may not be able to grant local buyers this advantage. As discussed above, in countries experiencing excessive inflation or currency depreciation or where a devaluation is expected, a CS may determine that accepting payment in the host country's currency or maintaining funds on deposit denominated in the host country's currency would be imprudent. The CS is authorized to safeguard against loss of a currency's purchasing power by requiring, at its discretion, that payment be made in a hard currency. The CS may accept payment in any currency other than U.S. dollars. Alternatively, the CS may elect to protect the value of monetization proceeds received in the currency of the host country by converting them into another currency. Once it has received payment, the CS is authorized to convert them into any currency, including U.S. dollars.[105]

[105] The use of the terms "foreign currency proceeds" and "foreign currencies" in Section 203 of P.L. 480, in which the "local sale and barter of commodities" is discussed, has been interpreted by USAID's Office of General Counsel (USAID/GC) to allow for payment for Title II commodities in any currency ***other than U.S. dollars***. Furthermore, GC's interpretation of the legislation allows for the conversion of monetization proceeds into any currency, ***including U.S. dollars***.

Chapter Thirteen

CALLS FORWARD

After reading Chapter 13 and/or receiving training in the chapter material, one should be able to:

- *discuss three important factors to consider when deciding when to call forward commodities*
- *differentiate between "price indications" and "price quotes"*
- *describe the information contained in FFP's Call Forward Status Report and explain why this report should be referenced before submitting a call forward*
- *list six items of information that should be submitted with the call forward*
- *discuss call forward deadlines*

13-1 Timing Calls Forward

A CS that is implementing or seeking to implement a Title II development project must present in its DAP/PAA a "Life of Activity Commodity Requirement Worksheet." This report provides FFP with projections for estimated tonnage (by commodity) over the life of the Title II program. A sample of this schedule is included as an appendix in the DAP/PAA Guidelines.

A more detailed plan, known as the "Commodity Procurement Schedule," must also be submitted with the DAP/PAA. In this schedule, the CS shows a breakdown, by month, of the type and amount of commodities that it wants to have ***at the U.S. port*** for the upcoming fiscal year of its program. The instructions for filling in this schedule are now shown on the sample schedule, which is included as an appendix in the DAP/PAA Guidelines. Timely submission and accurate preparation of procurement schedules are critical in order to assure the smooth procurement of commodities by FFP and USDA.

The factors that should weigh heavily in a CS's ultimate decision to call forward commodities are:

- the seasons of food shortage in the country where the food will be monetized. CSs should avoid monetizing Title II commodities immediately after harvest time, when food is plentiful and the sale of food aid commodities in the local market would compete with the sale of locally produced commodities.

- the amount of proceeds the CS has on hand to carry out operations. CSs want to avoid disruptions in programming resulting from shortages of proceeds (in order to avert such disruptions, the MFM suggests carrying over a five-month pipeline from one fiscal year to the next[106]). Alternatively, in countries plagued by inflation or currency depreciation or where a currency devaluation is expected, the CS will want to

[106] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section VIII.C. of the Implementation Guidelines. Note that the MFM further states that the

avoid keeping excessive balances on hand. As discussed in Chapter 12, the CS may wish to call forward a sizable quantity of commodities but then monetize in smaller tranches.

- expected importations of other food assistance commodities. CSs want to avoid calling forward Title II commodities that would arrive at the same time as Title I, Title III, Food for Progress, 416(b), or non-U.S. donated commodities. At this time, communication within and among U.S. donor agencies concerning commodity importation schedules needs to be improved. Discussions are underway within the Food Aid Consultative Group (FACG) on how to improve communication both within USAID and between USAID and USDA. For now, CSs should ask the USAID Mission about the timing of Title III importations and the U.S. Embassy Agricultural Attaché about Title I and Food for Progress importations. CSs should also contact non-U.S. donors to request their importation schedules.

- expected commercial importations of food, the sale of which could compete with monetization sales.

- any large food or non-food importations that could potentially tie up ports or other transport systems.

13-2 Preparing for a Call Forward

When the CS has made the decision to call forward commodities, it must gather up-to-date price information for both the procurement and sale of the commodities to be monetized. This information is used in the recalculation of the cost recovery estimate.

13-2.1 Price Quotes

The CS obtains procurement price information, known as a "price quote," from BHR/FFP/POD, which is ultimately provided by USDA. A price quote is different from the price indications the CS used to calculate cost recovery estimates during the project's market analysis and proposal preparation phases. Whereas price indications can be obtained from any number of sources, a price quote must be obtained, via a ***written*** request, from BHR/FFP/POD. The CS's ***written*** request[107] should include the following information so that BHR/FFP/POD can obtain accurate price information from USDA:

- the exact specifications of the commodities that will be called forward
- the time frame within which the CS requires delivery at the U.S. port

The MFM states that BHR/FFP/POD is required to respond, in writing, to a written request for a price quote within three business days.

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appropriate amount of funding carry-over depends on the activity being implemented and that the CS may justify additional carry-over.

[107] FFP has accepted written requests in the form of e-mail.

Special Note: The price quote that BHR/FFP/POD provides represents the FAS price quotation that will be used to determine cost recovery. As a result, the CS should keep careful track in its monetization files of all price quotes for each call forward and each country program. Unless otherwise specified, price quotes remain valid for a period of 90 days.

13-2.2 Sales Price Information

When the CS is ready to call forward commodities, it must also have up-to-date information on the sales price it expects to obtain in the market where the commodities are to be monetized. The CS should be aware at all times of the approximate local market price of the commodities it is programming. However, prior to actually calling forward commodities, the CS will need to ascertain the most accurate estimate possible of the price at which it will be able to monetize the commodities in the local market.

In those negotiated or other types of monetizations in which sales agreement is signed prior to the submission of the call forward, the price established in the sales agreement should be used in the cost recovery calculation. However, in those monetizations that occur in smaller lots and in greater frequency over an extended period of time, the exact sales price will be impossible to obtain prior to preparing the call forward. This is because the event that establishes the exact price, i.e., the actual sale of the commodity, will occur subsequent to the preparation of the call forward and the purchase, shipment, and arrival in-country of the commodities.

A CS can deduce a best estimate of the sales price by obtaining the most complete information possible. Sources for this information include historical data from previous sales and forecasting reports of future production or price trends. Neither of these is necessarily more accurate than the other, but the critical issue is to review extensively all available sources of data.

13-2.3 Call Forward Status Report

On its Internet website, FFP publishes a “Call Forward Status Report.” This report includes the following information:

- the current fiscal year’s approved Title II programs, listed by country and then by CS
- the type(s) of commodity(ies) and tonnage level(s) that have been approved for each CS program
- the amount of commodity, by country and CS program, that has already been called forward
- the amount of commodity, by country and CS program, that has yet to be called forward

This report is available at www.info.usaid.gov/hum_response/ffp/cfwd.txt. The CS should review this report when preparing a call forward to ensure that the type of commodities being requested as well as the tonnage level agrees with what FFP has approved.

13-3 Submitting the Call Forward

The MFM states that the following information must be provided to FFP with the call forward:

- clear commodity specifications
  Section 7-6 of this manual discusses commodity specifications in detail. The importance of providing exact specifications in the call forward cannot be overstated. The buyer undoubtedly has expectations about the characteristics of the commodity s/he is purchasing. If these requirements are not met, the buyer may refuse to purchase Title II commodities in the future.

- for negotiated sales,
  – written verification that a signed contract is in place and confirmation of the negotiated sales price, or
  – CS certification of the expected sales price, which must meet or exceed the cost recovery benchmark;

- for tender sales/auctions,
  – adequate evidence that the market is competitive or can be made so;
  – CS certification of the estimated sales price, which must meet or exceed the cost recovery benchmark

- mission concurrence on the call forward[108]

The CS may submit a revised cost recovery estimate (based on the price quote it obtains from BHR/FFP/POD and current sales price information). (See Section 7-2.1 for more information on cost recovery calculations.) Alternatively, if the CS does not provide a revised cost recovery estimate, FFP will calculate one using the price quote it obtained from USDA and sales price information provided by the CS with the call forward.

Note that the CS must be quite certain that the commodity sale will meet or exceed the cost recovery benchmark before commodities are called forward. If it appears unlikely that the benchmark will be met, then the CS must submit a waiver request to the FFP/D. (See Section 7-2.2 for a discussion of waivers.)

Special Note: In addition to the above, the CS should also provide the following information in order to expedite the processing of the call forward:

[108] *Monetization Field Manual: P.L. 480 Title II Programs*, Office of Food for Peace (USAID), October 16, 1998, Section V.A. of the Implementation Guidelines.

- ***freight rates to the destination port on a non-U.S.-flag carrier.*** *The MFM states, "Estimated non-U.S.-flag rates must be obtained from the CS's freight forwarding agent during proposal preparation and at the time of the call forward. At the time of the call forward, the CS must provide BHR/FFP/POD with the certification of sales price along with the freight indication in support of the call forward."*[109]

- ***fumigation requirements.*** *CSs' freight forwarding agents often advise their clients to include instructions for fumigation in their calls forward. Some countries require special fumigation treatment for commodities destined for their ports. It is best that the CS learn of these requirements during the proposal preparation stage and include them in their DAP. Any special requirements should then be reiterated in the call forward.*

- ***inspection certificates.*** *A list of the required inspection certificates should be itemized in the call forward, including the certificates that confirm commodity specifications, e.g., protein content.*

- ***containerization requirements.*** *Commodities that are shipped in containers are less susceptible to damage and loss during loading, transit, and unloading. However, containerization increases the cost of freight, which may make meeting the cost recovery benchmark more difficult. In cases where the monetization of commodities will take place far from the port of entry, the CS may wish to consider requesting that the commodities be shipped in containers. This should be discussed in the DAP and directly with BHR/FFP/POD prior to the submission of a call forward. If the CS does elect to require containerization, the call forward should reflect this.*

- ***special marking requirements.*** *The MFM states, "Commodities for monetization will arrive in country with the following 'abbreviated markings': description of contents, net weight, and USAID contract number. The phrase 'not to be sold or exchanged' will not appear. . .. If a CS has special marking requirements, the requirements must be specified in the proposal, if possible, as well as at the time of the call forward."*[110]

13-4 Delays in Call Forward Approval

CSs can avert delays in the approval of their calls forward by ensuring that:

- The program has been approved for that fiscal year by FFP.

- The commodity(ies) and tonnage level(s) being called forward agree with those that were authorized in the CS's AER. The CS can reference the Call Forward Status Report discussed in Section 13-2.3 above to confirm approved commodities and tonnage levels.

[109] *Ibid.*, Section I.B. of the Implementation Guidelines.
[110] *Ibid.*, Section VI.D. of the Implementation Guidelines.

- All the relevant information listed in Section 13-3 above is included in the call forward.

13-5 Call Forward Deadlines

Bulk commodities (i.e., commodities that are not processed, fortified, or bagged) may be called forward at any time because USDA procures bulk commodities on an order-by-order basis.

In contrast, USDA combines orders it receives for processed, fortified, and bagged commodities and procures them on a monthly basis. As a result, calls forward for these types of commodities must be submitted to FFP/W no later than the 4th day of the month. In those months where the 4th is not a business day, FFP adjusts the call forward deadline. Refer to www.info.usaid.gov/hum_response/ffp and click on "Commodity Procurement Schedule"[111] to obtain FFP's current listing of call forward deadlines.

Note that processed, fortified, and bagged commodities that are requested in a call forward submitted on or before the 4th of the month will be procured by USDA the following month. This is clearly shown on FFP's Commodity Procurement Schedule. CSs can expect to receive processed, fortified, and bagged commodities at the ocean port approximately three to five months after the call forward is approved by FFP/W. Bulk commodities generally can be expected to arrive at the ocean port within two to four months following FFP/W's approval of the call forward.

[111] Note that the Commodity Procurement Schedule mentioned here should not be confused with the commodity procurement schedule mentioned in Section 13-1. The CS must submit the latter with the DAP and then annually as part of the PAA.

Chapter Fourteen

COMMODITY SHIPMENT

After reading Chapter 14 and/or receiving training in the chapter material, one should be able to:

- *provide an overview of the events that occur prior to commodity shipment*
- *state the optimal time for buyers to take delivery of commodities*
- *discuss two reasons a buyer might give for rejecting commodities when they arrive at the port and ways to address the buyer's claim*
- *explain what a bill of lading is*

14-1 Introduction

The purpose of this chapter is to give a brief overview of the commodity shipment process. A number of other documents that provide greater detail about commodity shipment are available from Food Aid Management's Food Security Resource Center. CARE's recently published *Care Food Resources Manual* is an excellent source of information.

14-2 Chain of Events Prior to Shipping

1) The CS must prepare a call forward in which it details the exact specifications of the commodity to be procured. (Refer to Chapter 13 for specific information about calls forward.)

2) After the CS's call forward is submitted to and approved by the Mission, it is forwarded to FFP for final approval. As mentioned in the last chapter, FFP checks the call forward to ensure that the commodity and amount being requested were approved in the CS's AER.

3) Assuming that the call forward requirements are met, FFP submits a procurement request to USDA.

4) USDA reviews the call forward to ensure that all the required information has been provided and, if so, begins the procurement process. USDA issues an "invitation for bids." Commodity suppliers respond with offers to sell and transport the required commodity to the U.S. port. USDA reviews the bids and determines the "lowest landed cost," i.e., the lowest cost of procuring the commodities and transporting them to the U.S. port. Ocean transportation is also acquired through a competitive process. A freight tender is issued, and shipping lines respond with their price quotes for transporting the commodities from the load port to the overseas port. The two primary factors that will influence the choice of shipping line are cost and flag requirements. The Cargo Preference Act of 1954 requires that 75 percent of P.L. 480

commodities be shipped overseas on a U.S.-flag vessel. Therefore, the shipping line that offers the lowest freight rate might not be selected if it is determined that the shipment must take place via a U.S.-flag vessel.

5) If fumigation is required, the CS should ensure this is reflected on the call forward. Fumigation may take place at the point of manufacture or on the ocean vessel, and a fumigation certificate should be issued.

14-3 Transport to U.S. Port

Commodities are shipped via truck, barge, or railcar to the discharge port. The CS (or its freight forwarding agent) is responsible for ensuring that the schedule for commodity shipment is met. Regulation 11 states that the CS must "notify USDA immediately if the vessel does not arrive at the U.S. port of export in accordance with the agreed shipping schedule. USDA will determine whether the commodity shall be: (1) Moved to another available outlet; (2) Stored at the port for delivery to the [CS] when a vessel is available for loading; or (3) Disposed of as USDA may deem proper."[112] The CS may be held liable for any additional expenses that may be incurred if it fails to meet the agreed shipping schedule.

14-4 Commodity Arrival at U.S. Port

Title to the commodities transfers to the CS once the commodities are offloaded at the port of discharge. Prior to loading for shipment to the overseas port, a representative from the Federal Grain Inspection Service (FGIS) of USDA examines the commodities for signs of damage and/or infestation. In addition, a representative from FGIS observes the loading of commodities onto the ocean-going vessel.

14-5 Commodity Arrival at Overseas Port

14-5.1 Responsibilities of the CS

The CS is responsible for arranging for a discharge survey agent to attend the discharge of the cargo at the overseas port to count or weigh the cargo and examine its condition prior to or during removal from the vessel's hold. The CS can either request USDA to appoint the agent, or appoint the agent itself. In either case, USDA pays for the services of the agent. Regulation 11 states, "If practicable, the examination shall be conducted jointly by the surveyor, the consignee, and the ocean carrier, and the survey report shall be accepted by all parties."[113] Section 211.9 of Regulation 11 provides detailed guidance on what to do if, on arrival, damaged commodities appear to be unfit for their intended use.

Whenever possible, the CS should require that the buyer(s) take(s) delivery of commodities when they arrive at the port. Often, however, this is not practicable. Section

[112] 22 CFR Part 211, Section 211.9(a).
[113] *Ibid.*, Section 211.9(c).

15-3 lists steps a CS can take to prevent loss of and damage to commodities after they have arrived at the overseas port. For example, the CS should ensure that adequate storage facilities are available for those commodities that will not be transferred immediately to the buyer. (This is a legal requirement to be met as part of the annual Bellmon certification.)

The sales agreement might stipulate that the buyer is responsible for the costs associated with off-loading, port expenses, customs discharge, and inland transport. Any of these costs that must be covered by the CS should be included in the cost recovery calculation. (See Chapter 7 for details about the cost recovery calculation.)

14-5.2 Buyer Rejection

A buyer might reject delivered commodities for two reasons:

1) The shipment arrived later than expected. To forestall buyer rejection resulting from a delay in delivery, the sales agreement should specify when the commodities are expected to be shipped rather than a delivery date.

2) The buyer claims that the commodity specifications do not meet its expectations. Sales agreements should incorporate a provision that stipulates that the buyer will accept the USDA export inspection. This will result in the buyer's assuming liability for any deterioration that may occur in transit. The MFM states, "A discount range should be included in the [sales] agreement in order to prevent failure on the part of the buyer in the event that the commodities do not meet the exact specifications as stated in the call forward."[114] Before agreeing to any price concessions, however, the CS should take the following two measures:

    a) If, in fact, the inspection documentation provides evidence that the commodities do meet the commodity specifications spelled out in the sales agreement, the CS should present this documentation to the buyer.

    b) If the buyer still insists that the commodities do not meet specifications, the CS should have samples of the commodity examined by a qualified independent inspector at the buyer's expense. If the buyer's claim is justified, the CS should offer the buyer a reasonable discount in accordance with the discount clause that was included in the sales agreement. If the buyer refuses to accept the commodities at a discounted price, the CS should contact other buyers in the country who might be interested in purchasing the commodities. If an alternative buyer cannot be found, the CS should contact the USAID Mission and FFP/W and ask whether the commodities might be diverted to another country in the region.

[114] *Monetization Field Manual: P.L. 480 Title II Programs,* Office of Food for Peace (USAID), October 16, 1998, Section VI.E.2. of the Implementation Guidelines.

14-6 Commodity Documentation

The bill of lading documents the details of the shipment. It includes the information in the box below:

The **Bill of Lading** for a Title II food aid shipment contains:

- shipper/exporter name and address
- booking # and bill of lading #
- consignee
- forwarding agent
- point and country of origin
- place of initial receipt
- vessel, flag, and port of receipt
- markings and container numbers; number of packages; description of packages and goods; gross (net) weight/measurement
- freight payable; exchange rate; declared value
- shipper's signature
- letter of credit details, if applicable, such as bank name and address and beneficiary's name

In addition to the bill of lading, all Title II food aid shipments may have an associated certificate of origin, a USDA invoice, a commercial invoice, a phytosanitary certificate, and an inspection report. When the commodities arrive at the port, an independent survey report, a stowage certificate, and a delivery receipt might also be issued. The buyer may also request a fumigation certificate, a grain inspection certificate, and/or a protein certificate.

Chapter Fifteen

COMMODITY LOSSES

After reading Chapter Fifteen and/or receiving training in the chapter material, one should be able to:

- *state the point in time at which the CS assumes title to and responsibility for Title II commodities*
- *list at least six measures a CS can take to avoid commodity losses*
- *discuss the CS's role with respect to commodities that have been transferred to host country counterparts*
- *cite the section of Regulation 11 that addresses commodity losses*
- *state the point in time at which the CS is relieved of responsibility for commodities that have been monetized*

15-1 Transfer of Title to the CS

Regulation 11 states that title to and responsibility for Title II commodities shifts to the CS "at the point in the United States at which the ocean carrier or its agents take possession of the cargo (generally f.a.s. or f.o.b. vessel U.S. port)."[115] Regulation 11 further states that "all costs and expenses incurred subsequent to the transfer of title to cooperating sponsors shall be borne by them except . . . that the United States may pay or reimburse the following costs: (i) ocean transportation costs from U.S. ports to the designated ports of entry abroad; or (ii) ocean transportation costs from U.S. ports to designated points of entry abroad in the case (A) of landlocked countries, (B) where ports cannot be used effectively because of natural or other disturbances, (C) where carriers to a specific country are unavailable, or (D) where a substantial savings in cost or time can be effected by the utilization of points of entry other than ports."[116] For emergency programs, Regulation 11 indicates that the USG will also cover costs incurred to transport commodities to storage and distribution centers.

15-2 Obligations of the CS

When it takes title to a shipment of Title II commodities, the CS inherits a range of duties and obligations. These duties and obligations are spelled out in great detail in Sections 211.5, 211.6, 211.7, 211.8, 211.9, and 211.10 of Regulation 11. CSs should ensure that someone on staff, both at headquarters and in each field office where Title II commodities are being programmed, is knowledgeable about the provisions of the Regulation.

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[115] 22 CFR Part 211, Section 211.4(b)(1).
[116] *Ibid.*, Section 211.4(c)(3).

15-3 Preventing Commodity Losses

Lost commodities can result in protracted disruptions to programming, legal battles, and damaged or severed relationships with commodity buyers, as well as considerable financial loss to the CS if it is found to be responsible for the losses . Wherever possible, the CS should transfer commodities to the buyer upon arrival at the port. this may not always be feasible, CSs should take the measures in the box below to prevent loss or damage to commodities at the overseas port.[117]

Precautions to Prevent Commodity Loss or Damage at the Overseas Port

Foreign Port Operations

- Consider stipulating "no night discharging of vessel" in the shipping terms.
- Assign a port officer and support team to supervise unloadings.
- Hire reliable surveyors (no necessarily the lowest bidders).
- Avoid storage at port warehouses.
- Direct-load to trucks for break bulk shipments when possible.
- Have reconstitution materials stocked/available at the port.
- Maintain a close relationship and communication with Port Authority officials, host government counterparts, ship agents, freight forwarders, surveyors, donor agencies, NGO partners, and transporters.

Standard Practices

- Avoid large shipments that will require long-term storage.
- Ensure that documentation required for customs clearance is received well in advance of vessel arrival.
- Include a penalty clause for all inland transport losses in transport contracts above the local market value.
- Coordinate truck convoys during periods of insecurity or for delivery to insecure areas.
- Treat food aid commodities as cash assets with high dollar value.
- Focus on training of commodity management staff.
- Maintain regular communication between headquarters and field staff.
- Adopt a first in/first out (FIFO) warehousing system.
- Immediately separate spoiled/infested commodities.
- Inspect the warehouses monthly and inventory physical balances vs. book balances.
- Ensure that needed equipment and materials are available at the warehouses.
- Stress good security practices at storage sites.

[117] These recommendations were prepared by CARE and appear on pp. 3-4 of the *Proceedings* booklet from the Commodity Storage and Loss Reduction Project Dissemination Workshops held in Port-au-Prince, Haiti, June 29-July 2, 1998 and in Johannesburg, South Africa, July 27-29, 1998. The booklet can be viewed on FAM's website at www.foodaid.org. Other commodity management handbooks and reports also cover this important topic and are available from the Food Security Resource Center at Food Aid Management.

15-4 Commodities Transferred to Host Country Counterparts

CSs retain title to and liability for commodities that are transferred to host country counterparts (referred to in Regulation 11 as "recipient agencies") who cooperate in the implementation of Title II project activities. Prior to transferring commodities, therefore, the CS should ensure that:

- Counterpart staff have been adequately trained in the receipt, storage, tracking, and distribution of Title II commodities.

- A Recipient Agency Agreement is in place that
  - describes the approved uses of commodities;
  - requires the counterpart to pay the CS the value of any commodities that are used for purposes not permitted under the Recipient Agency Agreement or that are lost, damaged, or misused as a result of the counterpart's failure to exercise reasonable care with respect to such commodities;
  - incorporates the terms and conditions of Regulation 11.

- A plan is in place for monitoring the counterpart's compliance with the terms of the Recipient Agency Agreement.

- Counterpart staff have been trained to prepare commodity reports required by the CS.

15-5 Procedures and Claims for Lost/Damaged Commodities

Section 211.9 of Regulation 11 provides extensive guidance on the procedures the CS must follow when commodities are lost or damaged. Listed below are the relevant citations.

Fault of CS prior to loading on ocean vessel - Section 211.9(a)
Fault of others prior to loading on ocean vessel - Section 211.9(b)
Ocean carrier loss and damage - Section 211.9(c)
Fault of CS in country of distribution - Section 211.9(d)
Fault of others in country of distribution and in intermediate country - Section 211.9(e)

The CS should thoroughly document all details concerning quality and quantity of commodity received, any and all causes of losses, relevant observations concerning handling by all parties which may contribute to losses, and the exact point of loss or damage. This facilitates recovery of damages by the USG and the CS.

15-6 Reporting Losses

Section 211.9(f) of Regulation 11 contains instructions on reporting commodity losses to USAID or the Diplomatic Post.

15-7 Disposal of Unfit Commodities

The CS must follow special procedures when commodities have been damaged and their fitness for consumption is in question. Section 211.8 of Regulation 11 spells out these procedures in detail.

15-8 Transfer of Responsibility for Monetized Commodities from CS to Purchaser

Regulation 11 explicitly designates the point at which the CS is relieved of responsibility for commodities that have been monetized. The Regulation states: “Cooperating sponsors are not required to monitor, manage, report on or account for the distribution or use of commodities after title to the commodities has passed to buyers or other third parties pursuant to a sale under a monetization program and all sales proceeds have been fully deposited in the special interest-bearing account established by the cooperating sponsor for monetized proceeds.”[118]

[118] 22 CFR Part 211.5(j).

Chapter Sixteen

REPORTING MONETIZATION SALES AND USE OF PROCEEDS

After reading Chapter 16 and/or receiving training in the chapter material, one should be able to:

- *state the deadline for submitting to USAID the results of individual commodity sales*
- *list the items of information that must be reported to USAID following each commodity sale*
- *name the report in which CSs who are implementing development-focused programs must present detailed information concerning all commodity sales that were transacted during the fiscal year*
- *state the deadline for reporting on commodity sales that were carried out during the fiscal year in support of emergency or transition programs*

16-1 MFM - Reporting Individual Commodity Sales

Within 30 days following a commodity sale, the CS field office must report in writing to the USAID Mission or REDSO (or directly to BHR/FFP/POD if there is no Mission or REDSO presence) the information shown in Appendix C of the MFM. The required information is presented below.

- date of sale
- country in which the commodities were sold
- fiscal year and call forward number
- commodity type and tonnage
- sales method used (tender bid, lottery, negotiated sale)
- if tender bid method used, then:
  - pricing system used (e.g., stop-out, fixed price, pay-bid)
  - number of bids received
  - lowest bid received and highest bid received from auction participants
  - minimum price and maximum price paid by buyers
- exchange rate used
- method of payment (letter of credit, bank guarantee, cash)
- CS's target price
- number of buyers
- FAS quotation
- foreign-flag freight rate estimate
- other charges that must be included in the cost recovery calculation[119]
- sales price(s)

[119] In accordance with the definition of the cost recovery benchmark, these charges would include: port clearing and handling costs and duties, estimated transport costs to move the commodity to the point of sale, and expenses associated with marketing the commodity.

16-2 Regulation 11 Reporting Requirements

With respect to monetization proceeds, Regulation 11 requires that "the cooperating sponsor (headquarters, if there is more than one office) shall annually provide AID/W a report on the receipt and disbursement of all monetized proceeds and program income by cooperating sponsors and recipient agencies. This report should include the source of the funds, by country, and how the funds were used. This annual report should be submitted to AID/W by December 31 of each calendar year for the fiscal year ending September 30 of that calendar year."[120] (See the next section for clarification of this requirement.)

16-3 Development Program Reporting Requirements

For development programs, BHR/FFP's annual Results Report Guidance extends the reporting deadline set forth in Regulation 11 (see the last sentence in 16-2 above) and instead requires that CSs provide information about monetization transactions in their Annual Results Reports.[121]

The guidance that was issued November 30, 1998, requires that the CS include the following information about monetization transactions in its Annual Results Report:

1) Provide a detailed analysis of the monetization transaction(s) that the CS was party to during [the fiscal year]. The analysis should include the following: date of each commodity sale; country where the sale took place and beneficiary country, if different; type of commodity and amount (in MT) monetized; sales method (tender bid, auction, negotiated sale); sales price per MT obtained; amount in U.S. dollars of foreign currency generated; and comparison of the actual sales price to the Cost Recovery Benchmark. Note that all of this information was reported to USAID within 30 days following each individual commodity sale. (See section 16-1 above.)

2). Discuss how the monetization proceeds were used. Also discuss the outcome of the monetization transaction(s) in terms of anticipated and unanticipated effects on local, regional, or national production, and marketing of the monetized commodity or its substitutes. Note whether the timing of the sale corresponded with the agricultural crop and market cycles in order to obtain the best sales price. Describe the methodology that [the] CS is using to ensure that the value of monetized proceeds does not diminish due to currency fluctuations and/or devaluation.[122]

16-4 Emergency and Transition Program Reporting Requirements

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[120] 22 CFR Part 211, Section 211(5)(l).

[121] Refer to *Bureau for Humanitarian Response Office of Food for Peace Development Programs Team P.L. 480 Guidelines for Annual Results Reports*. The most recent version can be obtained from CS headquarters.

[122] *Bureau for Humanitarian Response Office of Food for Peace Development Programs Team P.L. 480 Guidelines for Fiscal Year 1998 Annual Results Reports*, Section I.C.

With respect to project reporting, BHR/FFP's Emergency Guidelines state that "expenditures vis-à-vis approved budget should be provided for the period for each funding component of the FFP approved project, including monetization, ITSH funds, and Section 202(e) grants."[123] More detailed guidelines for reporting on monetization proceeds have not been developed for emergency and transition programs. Therefore, CSs must ensure that they comply with the general requirements set forth in Regulation 11 (see Section 16-2 above) as well as those spelled out in the MFM for individual commodity sales (see Section 16-1 above).

[123] *PVO Guidelines for Title II Emergency Food Proposals and Reporting*, Office of Food for Peace (USAID), Section 5.D.

Chapter Seventeen

THIRD-COUNTRY MONETIZATIONS

After reading Chapter 17 and/or receiving training in the chapter material, one should be able to:

- *define the term "third-country monetization"*
- *give two examples of approved third-country monetizations and one example of a disapproved third-country monetization*
- *list at least three reasons why a CS might consider conducting a third-country monetization*
- *summarize each of the six provisions in the MFM that guide the implementation of a third-country monetization;*
- *identify at least two drawbacks to third-country monetizations and suggest how each might be addressed*

17-1 Definition of Third-country Monetization

A third-country monetization is one in which commodities are sold in one country and the foreign currency generated is used to support the implementation of a Title II program in that country and/or another country in the same region.

17-2 P.L. 480 and Third-country Monetization

The P.L. 480 legislation specifically authorizes third-country monetization. Section 203(b) of the law states that ". . . the Administrator shall permit private voluntary organizations and cooperatives to sell, in recipient countries, *or in countries in the same region*. . ." (Emphasis added.)

The following examples illustrate how the term "in the same region" has been interpreted in the past:

- Commodities have been monetized in Chad to support Title II programs in Mali, Chad, and Burkina Faso.

- Commodities have been monetized in El Salvador to support a Title II program in Nicaragua.

- Commodities have been *prohibited* from being monetized in Peru to support a Title II program in sub-Saharan Africa.

17-3 Reasons for Monetizing in a Third Country

CSs might consider conducting a third-country monetization for one or more reasons.

- The benefits that would accrue to the third country are greater than those that would be realized in the country of activity.

- The scheduled importation of non-Title II food aid or commercially supplied commodities in the country of activity is such that the CS could not monetize Title II commodities at an acceptable price.

- Millers/refiners in the country of activity are operating at full capacity at the time of a scheduled monetization and cannot accommodate additional commodities.

- Normal market operations in the country of activity have been interrupted because of a natural disaster or other emergency.

- The government in the activity country has unexpectedly imposed a high tariff on the commodity to be monetized.

- Unexpected importations by other donor programs temporarily make monetization impracticable in the activity country.

17-4 Bellmon and UMR Analyses

A Bellmon analysis must be carried out for **each country** in which Title II commodities will be sold. In addition, a UMR analysis may be required if the third country is a large commercial importer of the commodity(ies) that will be monetized. If a UMR analysis is deemed necessary, FFP will coordinate with USDA and the Department of State to conduct the analysis. (For more information on UMR, refer to section 5-7 of this manual.)

17-5 USAID Guidance for Third-country Monetizations

MFM guidance with respect to third-country monetizations, found in Section XI. of the Implementation Guidelines, is summarized below:

1) The first provision of the guidance requires that the CS's monetization request first address monetization in the activity country. In other words, to the extent possible, the CS should seek to monetize commodities in the country that is benefiting from the CS's food security activities. If the CS can demonstrate that sale in the activity country of all or a portion of the commodities to be monetized is impracticable, the CS may seek authorization from FFP to monetize in an LIFDC[124] within the same region as the activity country. If the CS further demonstrates that the sale of

[124]The current (or "most recent")list of LIFDCs is can be viewed at www.fao.org/spfs/list-e.htm and is included with this manual as Appendix 17.1. Prior to initiating any third-country-related activities, the CS should contact FFP/POD to ask whether the list has been updated.

commodities in any other LIFDC within the region is impracticable, then it may seek approval to monetize in a non-LIFDC located in the same region as the activity country.

The MFM notes that special consideration will be given to third-country monetization requests in which the CS has demonstrated that the benefits from the sale of commodities in a third country would be greater than the benefits that would accrue to the CS's activity country.

2) The second provision states that the USAID Mission operating in the third country is responsible for reviewing and either concurring with or disapproving the CS's Bellmon analysis, i.e., making the Bellmon Determination. The guidance notes that if there is no Mission, FFP will make the Determination.

3) The third provision requires that the CS work with the USAID Mission in the third country to ensure that the government of the third country does not object to monetization proceeds being transferred out to the CS's activity country.

4) The fourth provision of the guidance addresses Usual Marketing Requirements. It states that the FFP, in coordination with USDA, will evaluate the CS's monetization request for third-country monetization to determine if a more comprehensive UMR analysis is required. USAID, USDA, and the Department of State will review potential UMR limitations; FFP will notify the CS of the results.

5) The fifth provision addresses the responsibilities of the benefiting Mission (i.e., the Mission in the activity country). The tasks that the benefiting Mission may be called upon to carry out include, but are not limited to: a) providing technical assistance to carry out a Bellmon analysis in the third country; b) assisting the CS with third-country clearances (i.e., Bellmon Determination and proceeds expatriation); c) assisting in the UMR process; and d) in conjunction with the CS, communicating with the third-country Mission or Embassy to alert them to pending third-country monetization requests. If the benefiting Mission is unable to perform these functions, FFP/W will provide assistance as long as management capacity and funding are available to do so.

6) The sixth, and final, provision of the guidance notifies CSs that monetization proceeds generated in a third-country can be converted to a hard currency for transfer to the country of program activity.

17-6 Drawbacks to Third-country Monetizations

A list of the challenges a CS might face in attempting to conduct a third-country monetization is presented below, along with corresponding suggestions for addressing each challenge.

- Finding an alternative market within the same region as the activity country could be difficult. USAID makes it clear that LIFDCs must be considered as the first alternatives. Only if the CS cannot identify an LIFDC as a candidate for a third-country monetization can it consider monetizing in non-LIFDCs.

  CSs have access to a great deal of information concerning markets in developing countries. A CS that wants to monetize in a third country should contact its field offices in other countries within the region of the activity country to ask about the potential to monetize in these markets. Other Title II CSs can also be asked to provide information about the markets in the countries where they are working. The Food Security Resource Center at Food Aid Management has an abundance of economic and market data that might prove useful. In addition, USAID Missions, Embassy Agricultural Attachés, and non-USG donors might be able to provide advice about potential markets for third-country monetizations.

- A third-country government may prohibit the monetization of food aid commodities since its constituents will not benefit from the activities supported by the monetization proceeds.

  In some cases, the government might simply be unfamiliar with Title II food aid in general or monetization in particular. The CS should be prepared to provide a thorough explanation of Title II monetization and to enumerate the benefits that would accrue to the third country from permitting such a transaction. The benefits might include:

  – *an increase in jobs, particularly if bulk commodities that require processing will be monetized*

  – *an increase in the amount of food available. If the country is an LIFDC, monetization could help to address issues of food availability.*

  – *the quality of Title II commodities. The commodities that would be monetized would be procured commercially by the U.S. Government, and would* not *be surplus commodities that have been in storage for an undetermined length of time.*

  In addition, the CS might consider trying to implement program activities in the country where the sales will take place, even if the majority of proceeds are being transferred to another country. This might facilitate acceptance by the third-country government.

- Commercial suppliers of food commodities to the third country might argue that the monetization of food aid would displace commercial sales.

  Having narrowed down the number of countries where it could potentially conduct a third-country monetization, the CS should contact commodity representatives. A list *of the associations that represent the interests of commodity producers and processors is included as Appendix K. The CS might use the existing Bellmon and/or the UMR analysis to show that the supplier would not be harmed by the monetization.*

- Non-USG food aid donors might object to the importation of additional food aid commodities into the third country, especially if they are monetizing their donated commodities in the country.

  As it narrows down the number of countries that could accommodate a third-country monetization, the CS should contact non-USG food aid donors and request their feedback. The CS might be able to convince these donors that the market can accommodate additional commodities by citing relevant sections of the Bellmon and UMR analyses. The CS should assure other food aid donors that the importation of Title II commodities would be timed so as not to conflict with other importations.

Chapter Eighteen

ENDOWMENTS

After reading Chapter 18 and/or receiving training in the chapter material, one should be able to:

- *explain what an endowment is*
- *discuss the relevance of USAID's "standard provisions" concerning endowments to monetization-funded endowments*
- *discuss the relevance of USAID's Policy Determination 21 to monetization-funded endowments*
- *list two advantages of endowments*
- *list two disadvantages of endowments*

> An **endowment** is a sum of money that has been invested in order to generate income to fund stated projects or activities.

18-1 Definition of an Endowment

An endowment is a sum of money that has been invested to generate income that will fund stated projects or activities. In most cases, only the income that is earned is disbursed, while the investment itself remains intact.

18-2 Authority for Establishing Monetization-funded Endowments

Section 203(d)(3) of P.L. 480 authorizes the use of monetization proceeds to establish endowments. The law specifically states, "Foreign currencies generated from any partial or full sale or barter of commodities by a private voluntary organization or cooperative under a non-emergency food assistance agreement under this title may be invested and any interest earned on such investment may be used for the purposes for which the assistance was provided to that organization . . ." Regulation 11 requires that endowments be established "with the approval of A.I.D."[125]

18-3 Guidance for Establishing/Implementing Monetization-funded Endowments

To date, USAID has not issued guidance for establishing and/or implementing Title II monetization-funded endowments. However, *cash grants* awarded to PVOs by USAID to establish endowments include specific standard provisions. There are two versions of the standard provisions for endowments:

1) Standard Provisions for an Endowment with U.S. Non-Governmental Recipient
2) Standard Provisions for an Endowment with Non-U.S. Non-Governmental Recipient

[125] 22 CFR Part 211, Section 211.5(k)(iii).

FFP has indicated that the appropriate version (#1 or #2) of the standard provisions would be incorporated in the approval documentation for any DAP in which the establishment of an endowment is authorized.

The two sets of standard provisions are included with this manual as Appendices 18.1 and 18.2.[126] The topics they cover include:

1) Accounting, Audits and Evaluations
2) Prohibited Uses
3) Refund and Termination
4) Source, Origin and Nationality
5) Procurement Policies
6) Title to Property
7) Nonliability
8) Amendment

The standard provisions do not provide guidance on the allowable uses of endowments. They do, however, highlight certain prohibited uses. The prohibited uses section of version #1 is reproduced below.

18-3.1 Prohibited Uses of Endowments

The Recipient [e.g., the CS] agrees that the Endowment will be used only for the purposes set forth in the Program Description [e.g., the DAP] and, in any event, that such funds will not be used:

(a) (1) to coerce any person to practice abortion; or

(2) to pay for the performance of involuntary sterilization or to coerce or provide any financial incentive to any person to undergo sterilization; or

(3) for military or paramilitary purposes; or

(4) to attempt to influence legislation in the United States, in the host country or elsewhere;*

(5) so as to inure, directly or indirectly, to the personal benefit of private persons, or be distributable to principals of the Recipient or the Asset Manager, except as such persons or their affiliates shall be authorized and empowered to receive reasonable compensation for goods sold or services rendered to or on behalf of Recipient or its subrecipients;

[126] The two appendices are also available on the Internet at www.info.usaid.gov/ftp_data/pub/handbooks/300/303518m2.pdf and www.info.usaid.gov/ftp_data/pub/handbooks/300/303518m1.pdf, respectively.

(b) (1) No Endowment funds may be used in a project or activity reasonably likely to involve the relocation or expansion outside of the United States of an enterprise located in the United States if non-U.S. production in such relocation or expansion replaces some or all of the production of, and reduces the number of employees at, said enterprise in the United States.

(2) No Endowment funds may be used in a project or activity the purpose of which is the establishment or development in a foreign country of any export processing zone or designated area where the labor, environment, tax, tariff, and safety laws of the country would not apply, without the prior written approval of USAID.

(3) No Endowment funds may be used in a project or activity which contributes to the violation of international recognized rights of workers in the host country, including those in any designated zone or area in that country.

(c) Recipient shall include the restrictions in subparagraphs a. and b. in subgrants made with Endowment funds.

*** This provision is not required by USAID. However, some Recipients have been advised by independent counsel that adherence to this provision is necessary in order to be granted 501(c)(3) status by the IRS.**

18-3.2 Policy Determination 21

In July 1994, USAID issued Policy Determination 21 (PD-21) known as "Guidelines: Endowments Financed with Appropriated Funds." These guidelines were released in response to earlier legislation that authorized the establishment of endowments by nongovernmental organizations.

Like the standard provisions discussed in Section 18-3, PD-21 guides those endowments that are established with cash grants awarded by USAID, and *not* monetization-funded endowments. Nevertheless, CSs who intend to seek USAID's approval to establish a monetization-funded endowment should be aware of the terms and provisions of the Policy Determination. PD-21 is included with this manual as Appendix S.

Another useful publication concerning USAID-funded endowments is entitled *Terms of Endowment: A New A.I.D. Approach to Institutional Development*. This report is attached as Appendix T.

18-4 Title II and Endowments

The number of endowments that have been funded with monetization proceeds is extremely limited. TechnoServe has established one type of endowment in Ghana known as the Community Enterprise Development and Investment (CEDI) Trust. The trust is used to provide partial funding for TechnoServe's enterprise development program in that country. It can also be used as a venture capital fund for investments, loans, or loan guarantees for rural enterprise development. (A report on TechnoServe's trust is attached as Appendix U.)

At the time this manual was drafted, FFP was reviewing its position regarding the establishment of endowments with monetization proceeds. Since it has not yet promulgated any formal policy, no list of program activities that might be supported by an endowment exists. For information on setting up an endowment with monetization proceeds, CSs are advised to contact FFP directly.

18-5 Advantages of Endowments

- An endowment represents an immediate source of cash that will be available when cash is needed and when cash from other sources is not available.

- Endowments may support local capacity building. Host country counterpart staff and beneficiaries who manage or access endowment income can learn valuable financial management skills.

- An endowment can be used as a tool for leveraging other resources. An existing pool of funds provided directly or indirectly by the U.S. government might well attract contributions from other donors.

- Endowments help to promote sustainability, allowing worthwhile projects that might otherwise be terminated when the CS withdraws to continue indefinitely.

18-6 Disadvantages of Endowments

- Establishing an endowment will most likely require detailed familiarity with host country laws and regulations. Lawyers' fees and document processing charges associated with establishing an endowment could be expensive.

- Administering an endowment requires a high level of financial management expertise. The CS may not have the expertise in-house needed to administer an endowment.